the institute for college access & success

ALIGNING THE MEANS AND THE ENDS:

How to Improve Federal Student Aid and Increase College Access and Success

FEBRUARY 2013

WHITE PAPER

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The views expressed in this report are those of The Institute for College Access & Success (TICAS) and do not necessarily reflect the views of its funders or any individuals or organizations referenced in this report.

TICAS is an independent, nonprofit organization that works to make higher education more available and affordable for people of all backgrounds. TICAS is home to the Project on Student Debt, which seeks to increase public understanding of rising student debt and the implications for our families, economy, and society. For more about TICAS, see ticas.org.

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Executive Summary

The need for higher education and training has never been so important to individuals and our economy as it is today. Yet, its affordability is seriously in question. College costs have skyrocketed as family incomes and state funding for public higher education have declined, leading millions to take on student debt, drop out, or struggle to keep up with classes while working too many hours to pay the bills. Even after recent significant increases, the maximum Pell Grant today covers the smallest share of the cost of attending a public college since the start of the program 40 years ago. It should be no surprise that the gaps in college enrollment, persistence, and graduation between children from high- and low-income families have widened over the last 30 years, threatening both the American Dream and our nation's economic competitiveness.

Although these gaps cannot be closed with financial aid policy alone, research shows that it can increase enrollment, persistence, and completion. Families would have had a much harder time paying for college over the last five years without the significant increases in Pell Grants, tax benefits, and G.I. Bill benefits. However, even with these increased investments, current federal financial aid policies have not closed the growing gaps in access and success. Based on the available research, there are at least five major reasons why:

- Available need-based grant aid is insufficient to overcome gaps in access and success.
- Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.
- The complexity of the current federal aid application process and programs undermines their effectiveness.
- States and colleges are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.
- Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

This white paper includes recommendations to address each of these problems by reforming federal grant, loan, and tax policies, increasing accountability, and providing students and families with the information they need to make wise decisions about where to go to college. Some of these changes require additional investments, and this paper includes options that would more than pay for the recommended reforms. Many of those options enjoy bipartisan support and have been endorsed by a broad range of organizations and experts, underscoring that the question is whether our nation has the will to make the needed changes.

Student Eligibility and Accountability: Simplify the aid application process while better targeting aid and preventing fraud.

There is widespread agreement that the current federal student aid application process is so complex in structure and timing that it can be an obstacle rather than a path to a college education. While significant progress has been made in recent years, the Free Application for Federal Student Aid (FAFSA) still rivals the full 1040 tax form in length. Students still do not learn how much aid they are eligible for until after they have already applied to colleges, and the lowest income students do not benefit from recent simplification measures. Research shows that both the timing and process can be greatly improved while still targeting aid to needy students.

- Calculate aid eligibility using the tax or W-2 data available when students typically apply to college. This one change would dramatically simplify the process for both students and schools, and tell students how much aid they can expect before, rather than after, they apply to colleges.

- Streamline the verification process that occurs after students submit the FAFSA to ensure eligible students get aid and reduce burdensome paperwork for schools and students.

- Improve the federal needs analysis formula to better target aid while reducing the number of questions that cannot be answered by existing tax and wage data.

- Better prevent fraud by having the U.S. Department of Education (the Department) flag aid applicants with histories that suggest fraud. In these cases, colleges should determine aid eligibility based on the applicant's total enrollment history, including at prior schools, so they cannot enroll and withdraw at school after school while receiving federal aid.

College Eligibility and Accountability: More closely tie a college's eligibility for funding to the risk students take by enrolling and the risk taxpayers take by subsidizing it, and reward schools that serve students well.

While students are, and should, be held accountable for studying and making progress toward a credential, there are few consequences for schools that fail to graduate large shares of students or consistently leave students with debts they cannot repay. Taxpayer dollars should not subsidize schools that routinely do more harm than good. The data are clear that some schools do much better than their peers at enrolling and graduating similar students without burdensome debt. To ensure that available federal aid dollars are spent wisely, we recommend more closely tying colleges' eligibility to the risks they pose to students and taxpayers. This means rewarding colleges that serve low-income students well with more funds and greater flexibility to innovate, while strengthening oversight and accountability measures to prevent waste, fraud, and abuse.

- Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR). The CDR reflects only the share of a school's student loan borrowers who default. The SDRI is the three-year CDR multiplied by the school's borrowing rate. By incorporating the share of students who borrow loans into the measure, the SDRI more accurately conveys a student's risk of defaulting at a given school.

- Require risk-sharing by schools if they receive a majority of their revenue from federal student aid and have SDRIs that are relatively high but fall below the eligibility cutoff. Currently, a school's eligibility for federal aid is all or nothing, with no risk-sharing in place, regardless of how much taxpayer funding it receives.

- Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment. By basing the additional funding on Pell Grant dollars disbursed, colleges would be encouraged to enroll low-income students and help them apply for aid and enroll full time.

- Let colleges with strong track records have more flexibility to innovate. With few exceptions, federal policies currently treat all colleges alike, regardless of their record of serving students well. This one-size-fits-all approach to regulation and oversight tends to over-regulate the best colleges and underregulate the worst.

- Improve oversight and other accountability measures to better protect students. Whether schools are sanctioned using the current CDR standards or a more robust SDRI, additional policy changes must be made to ensure the integrity of the federal student aid programs.

Grant Aid: Secure and improve Pell Grants.

Research shows that need-based grant aid increases college enrollment among low- and moderate-income students and reduces their likelihood of dropping out of college. In particular, studies have found that Pell Grant recipients are more likely than other low-income students to stay enrolled and succeed. Research also suggests that the current complexity of the Pell Grant program and the fact that students do not know how much aid they will receive until after they have applied to colleges reduces Pell's effectiveness. However, even the best designed program will not be effective if it is not adequately funded. To close the widening income gaps in college access and success, we need to both improve the Pell Grant program in ways that do not cost money and dramatically increase our investment, while requiring that states and colleges also do their share.

- Double the maximum Pell Grant to close income gaps in access and attainment. Based on existing research, the maximum Pell Grant needs to be dramatically increased to overcome the current income gaps in enrollment and completion. Even a doubled maximum grant of $11,270 would cover a smaller share of the cost of attending a public college than it did in the late 1970s.

- Make Pell Grants a mandatory program. As long as Pell Grant funding is subject to annual appropriations based on projections that can turn out to be too high or too low, its cost and funding will never be perfectly aligned. This puts the program in jeopardy, creating unnecessary uncertainty for students and schools and putting college access and success at risk.

- Rename Pell Grants as Pell Scholarships to better convey the academic expectations of all recipients.

- Limit Pell eligibility while enrolled less than half time to two terms, to encourage timely completion while recognizing the challenges facing low-income students.

- Limit Pell eligibility to 7.5 years, excluding up to one year of remedial coursework, to allow completion of a bachelor's degree while meeting requirements for satisfactory academic progress. Current federal aid policies permit students to take up to 7.5 years to complete their bachelor's degree, but low-income students may only receive Pell Grants for up to six years.

- Congress should consider maintenance of effort provisions to ensure that new federal dollars supplement – rather than supplant – state and other forms of higher education funding and financial aid.

Student Loans: Reduce complexity, improve targeting, contain debt burdens, and encourage completion and wise borrowing.

The current federal student loan program is too complex, its terms are too arbitrary, and its benefits are poorly targeted. Much of the complexity is a holdover from when banks received subsidies to make Stafford Loans that were guaranteed by the government, shielding lenders – but not borrowers or taxpayers – from risk. Now that these loans are made directly and more cost-effectively by the Department of Education, the entire student loan system can and should be streamlined and improved. Subsidized Stafford Loans currently provide students with particularly valuable benefits, including a low fixed interest rate and no interest accrual while the student is in school. However, these benefits are not well targeted, as high-income students may qualify just because they attend a high-cost college. In addition, eight in 10 students with subsidized loans also have unsubsidized loans, diluting the subsidy's benefits. In July, the subsidized loan's interest rate is scheduled to double from 3.4 percent to 6.8 percent, while interest rates on 10-year Treasury notes are currently two percent. Reform is clearly and urgently needed. Our loan recommendations aim to better support access and success while containing costs and risks for both students and taxpayers.

- Provide a single undergraduate student loan with a fixed interest rate and no fees, in place of the two types of Stafford Loans available today. To support and encourage students to stay enrolled and complete, the loan would have a low interest rate while the student is in school, based on the government's cost of borrowing. When the loan enters repayment, the interest rate would rise by a set margin, but the total rate could never exceed a designated cap.
    - To help borrowers who go to school when interest rates are unusually high, the loan would have a built-in form of insurance that would keep their rates from ever being too much higher than the rate on loans being offered to current students.

- To provide a targeted safety net for borrowers from low-income families, Pell Grant recipients would be eligible for interest-free deferments during periods of unemployment and economic hardship.

- Streamline and improve federal loan repayment options by:
  - Offering one income-based repayment plan that lets any borrower choose the assurance of manageable payments and forgiveness after 20 years. Right now there are three such plans with different eligibility criteria and payment formulae, with one more set to launch in 2014. Our proposal simplifies and improves this important repayment option.
  - Enabling borrowers to make one payment that covers all their federal loans, and basing standard repayment periods on the borrower's total federal student loan debt. These changes reduce unnecessary complexity and obstacles to continuous, on-time payments.

- Improve the timing, content, and effectiveness of student loan counseling to help students borrow wisely, complete college without burdensome debt, pick a repayment plan that works for them, and repay their loans.

- Prevent student loan defaults by automatically enrolling severely delinquent borrowers in an income-based repayment plan; targeting outreach to borrowers showing signs of financial distress; and providing discharges when students are defrauded by their college, to be paid for by the school.

- Reduce financial distress by reconsidering the use of private debt collectors for defaulted federal loans; protecting income for basic necessities when collecting on defaulted loans; and ensuring there is a way out of default for all borrowers willing to take responsibility.

- Strengthen consumer protections for private loan borrowers by requiring school certification for all private education loans; enabling private loan borrowers to refinance or modify their loans; and treating private loans like credit cards and other similar types of debt in bankruptcy.

Tax Expenditures: Streamline and improve the targeting of higher education tax benefits.

Current higher education tax provisions are too poorly timed and poorly targeted to efficiently increase college access or success. We therefore recommend eliminating them and redirecting the savings (more than $100 billion over the first five years alone) into Pell Grants and incentive funds for states and colleges to increase college access, affordability, and success. Nevertheless, there is strong bipartisan support for higher education tax benefits. The American Taxpayer Relief Act of 2012 included more than $90 billion in such benefits that would have otherwise expired, including the extension of two of the most regressive and poorly targeted benefits: the student loan interest deduction and the tuition and fees deduction. If Congress is unwilling to eliminate current tax expenditures and redirect the savings to Pell Grants and other programs that more effectively and efficiently support college access and success, then we recommend dramatically streamlining and improving the targeting of higher education tax benefits. Our other tax recommendations call for simpler and more equitable tax treatment of Pell Grants and forgiven loans.

- If higher education tax benefits are to be retained, we recommend:
    - Streamlining the benefits by creating an improved American Opportunity Tax Credit (AOTC). Research suggests the AOTC is the most likely of the current tax benefits to increase college access and success. We recommend improving its likely efficiency and effectiveness by enhancing its benefits for low- and moderate-income students and for students attending community colleges. These changes would be paid for by eliminating other less targeted, less effective tax benefits, including the tuition and fees deduction, student loan interest deduction, Lifetime Learning Credit, and exclusion of earnings from Coverdell education savings accounts.
    - Better aligning eligibility for higher education tax benefits with student aid administered by the Department.
- Stop taxing forgiven or discharged student loans as income. Regardless of the reason for the discharge, no discharged or forgiven student loan debt should be treated as taxable income. This will correct current inequities that, for instance, exempt discharges resulting from school closures from taxation while taxing discharges for totally and permanently disabled borrowers.
- Stop taxing Pell Grants as income. To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income if they are used for a qualified education expense.

Better Information: Provide students with key information when they need it.

We can increase the impact of financial aid by providing students and families with key information when they need it to make decisions about whether to go to college, where to go, and how to pay for it. However, much of the information students and families need is not currently available, or not available in a way that students can easily find and use. College is too important, and families and taxpayers pay too much for it, for us to lack basic information about costs, aid, and outcomes.

- Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates. Before they decide where to apply and go to college, students need to know their chances of graduating and their chances of graduating with debt, particularly high debt and/or risky private loan debt. It is crucial that such data be collected and made available to both consumers and policymakers given rising debt and default levels.
- Provide proactive estimates of federal aid eligibility so students know they can afford college, and improve the free, online FAFSA4caster so it is easier to compare likely aid to costs at specific colleges. For students and families ready to select schools, create and

promote College Scorecards with key information on every college, and make net price calculators easier to find, use, and compare.

- Require all colleges to use a standard format for financial aid award letters that makes it easy for families and students to understand and compare what they would need to save, earn or borrow at each college to which they have been admitted.
- Conduct consumer testing to ensure that information is presented in the most effective way, including for audiences with little or no college knowledge or experience.

Introduction

The American Dream envisions a nation where everyone can fully participate in our democracy, and our fates are determined by ability and accomplishment rather than circumstances of birth. Ensuring college access and increasing student success are crucial to achieving and preserving that dream and the economic opportunity and mobility on which it depends. College education is increasingly the primary path to stable employment, higher wages, retirement benefits, and health insurance, as well as a key predictor of civic participation, better health, and the next generation's odds of getting ahead – or at least not falling behind. An educated workforce is also essential to America's economic competitiveness: our nation needs more people to get quality training and education after high school than ever before. However, as college education has become more essential for all these reasons, income gaps in enrollment and completion have widened rather than narrowed.

To meet the broadly shared goal of greatly increasing the share of Americans with a college education, federal student aid policies must be improved to expand access and better support success for lower income students. When student financial aid works as it should, students who are willing to study hard can afford to go to college, which is what we mean by college access; and they can complete a meaningful degree or certificate without burdensome debt, which is what we mean by student success.

For this white paper, we analyzed the latest data on the cost and distribution of major federal grants, loans, and tax benefits intended to help students and their families pay for college. We reviewed the most current and robust research and analyses to assess how well these sources of aid support student access and success and the key obstacles to increasing low-income students' completion of quality credentials. Based on this analysis, we developed evidence-based guiding principles and used them to identify reforms likely to have a substantial positive effect on college access and success. Below is a description of our main findings and principles, followed by specific policy recommendations in six major areas: Student Eligibility and Accountability; College Eligibility and Accountability; Grant Aid; Student Loans; Tax Expenditures; and Better Information. An appendix provides options to pay for the reforms we propose.

Section 1: Context, Evidence, and Principles for Reform

College is increasingly important for economic growth and opportunity, but more families are struggling to pay for college.

The many benefits of higher education have been well documented over time. According to the Georgetown Center on Education and the Workforce, holding a bachelor's degree is associated with a median lifetime income of $2.8 million, 84 percent higher than a worker with a high school diploma.[1] Additionally, the unemployment rate for workers with a degree is significantly lower than for those without: in 2012, 4.5 percent for workers with a B.A. compared to 8.3 percent for those with a high school diploma.[2] These differences are even starker for young adults aged 25 to 34: those with only a high school diploma are more than three times as likely to be unemployed as those with a bachelor's degree.[3] A recent report released by The Pew Charitable Trusts showed how these benefits helped college graduates weather the recent economic upheaval. Although all groups of workers were hit by the recession, recent college graduates suffered significantly smaller increases in unemployment and smaller declines in wages than their non-degreed peers.[4] In addition to the wage premium and higher rates of employment, college graduates are more likely to have health and retirement benefits. Even after controlling for personal characteristics, on average college graduates are also more satisfied with their jobs, healthier, and more involved citizens and parents.[5]

The public is also well aware of the value of a college education. Recent surveys consistently find nearly universal recognition of its importance for individuals and the economy, widespread concerns about costs and debt, and broad support for making college affordability and financial aid policy priorities.[6]

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[1] Georgetown University Center on Education and the Workforce. 2011. *The College Payoff: Education, Occupations, Lifetime Earnings*. http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/collegepayoff-complete.pdf.

[2] U.S. Department of Labor, Bureau of Labor Statistics. 2012. Employment Projections. "Education Pays." http://www.bls.gov/emp/ep_chart_001.htm.

[3] Calculations by TICAS on data from the U.S. Census Bureau, Current Population Survey, 2012 Annual Social and Economic Supplement, Table PINC-04; and unpublished data from the Bureau of Labor Statistics, Current Population Survey, 2011 annual average for unemployment rates. Young adults are defined as persons aged 25 to 34.

[4] The Pew Charitable Trusts Economic Mobility Project. 2013. *How Much Protection Does a College Degree Afford: The Impact of the Recession on Recent College Graduates*. www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_college_grads_recession_report.pdf.

[5] The College Board. 2010. *Education Pays 2010: The Benefits of Higher Education for Individuals and Society*. http://trends.collegeboard.org/education-pays.

[6] Hart Research Associates, commissioned by HCM Strategists. 2013. *College Is Worth It: A Report On Beliefs About The Importance Of College, Impressions Of The Financial Aid System, Priorities For Reform, And Reactions To Potential Reform Approaches.* http://hcmstrategists.com/americandream2-0/report/FINALHartPublicOpinionResearch.pdf. Lake Research Partners and Bellwether Research and Consulting, commissioned by TICAS, Dēmos, and Young Invincibles. 2011.

Despite strong public support for higher education, and its clear monetary and nonmonetary value, the demand for college-educated workers is projected to increase at double the rate of the supply.[7] State funding for public colleges has declined by almost one-fourth since 2002, while tuition and fees at four-year public institutions have increased by 5.2 percent annually over the same period *after* adjusting for inflation (2.4% for private nonprofit four-year colleges and 3.9% for public two-year schools).[8] Students also have to cover other costs such as books, food, and housing, which are considered part of the full cost of attendance and have increased as well. Meanwhile, the average family income is less today than it was a decade ago.[9] To illustrate the growth in college prices compared to other changes in the economy, compare two students working full time over the summer to cover college costs. In 1980, at the average public four-year school, a student who worked full time over the summer at a minimum wage job could cover tuition the next year and have the 2012 equivalent of $1,923 left over.[10] In 2012, a student who worked full time over the summer at a minimum wage job would cover only 42 percent of tuition at an average public four-year school, leaving them $4,764 short. The United States will not be able to meet the economy's demand for college-educated workers without addressing college affordability.

With college costs and family incomes going in opposite directions, it is no surprise that students from lower income families have struggled to pay for college. Even after taking into account grant aid, the lowest income families would have to contribute almost three-quarters (72%) of their annual household income each year to cover the net price of sending one child to a four-year college, whereas middle- and high-income families would have to contribute amounts equivalent to 27 percent and 14 percent of their yearly earnings, respectively.[11]

This outsized impact of increased costs on lower income students is a major factor in the widening gap in college access and success by income.[12] In 2010, the gap in immediate college enrollment between high school completers from low-income families and those from high-income families was 30 percentage points (52% and 82%, respectively), and new research in 2011

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http://ticas.org/pub_view.php?idx=793. Hart Research Associates, commissioned by the College Board. 2011. *One Year Out: Findings From A National Survey Among Members Of The High School Graduating Class Of 2010.* http://media.collegeboard.com/homeOrg/content/pdf/One_Year_Out_key_findings%20report_final.pdf. Public Agenda. 2011. *Slip-Sliding Away: An Anxious Public Talks About Today's Economy and the American Dream.* http://www.publicagenda.org/pages/index.php?qid=245. Pew Research Center. 2011. *Is College Worth It?*

College Presidents, Public Assess, Value, Quality and Mission of Higher Education. http://www.pewsocialtrends.org/2011/05/15/is-college-worth-it/.

[7] Georgetown University Center on Education and the Workforce. 2011. *The Undereducated American*. http://cew.georgetown.edu/undereducated

[8] The College Board. 2012. *Trends in College Pricing 2012.* http://trends.collegeboard.org/college-pricing. Figures 4 and 12a.

[9] Ibid. Figure 18a.

[10] Young Invincibles. 2012. *Student Perspective on Federal Financial Aid Reform*. http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf.

[11] The Education Trust. 2011. *Priced Out: How the Wrong Financial-Aid Policies Hurt Low-Income Students.* http://www.edtrust.org/sites/edtrust.org/files/PricedOutFINAL.pdf.

[12] The Advisory Committee on Student Financial Assistance (ACSFA). 2006. *Mortgaging our Future: How Financial Barriers to College Undercut America's Global Competitiveness.* http://www2.ed.gov/about/bdscomm/list/acsfa/mof.pdf

showed that children born to families in the top income quartile are more than twice as likely to enroll in college, and six times as likely to complete a B.A. by age 25, as those in the bottom income quartile.[13]

Both to meet the human capital needs of the economy and to ensure equal opportunity for all Americans, it is imperative that we design public policy to maintain and increase college access and student success.

Although access and completion gaps cannot be closed with financial aid alone, research shows that aid can and does increase enrollment, persistence, and completion.

Many of the causes of income gaps in college access and success lie beyond the reach of financial aid policy. For instance, first-generation students whose parents have limited college knowledge may find it impossible to navigate the process of applying. Students who leave high school ill-equipped for college are less likely to succeed once they are there. Just as financial aid can help to make college more affordable, investments in other supports – including outreach, counseling, and tutoring – are critical to overcome other barriers to access and success to truly close the gaps.

Research has shown that, even among students with similar academic preparation attending similar types of schools, income gaps in college access and completion persist. By reducing the gap between the cost of college and what families can afford to pay, financial aid can help increase enrollment, persistence, and completion. When that gap is not fully closed, the remainder is called "unmet need." Students with more unmet need are less likely to enroll in college than those with less, and enrolled students who have unmet need are less likely to earn degrees than those who do not.[14] Having sufficient resources to cover college costs – from savings, earnings, grant aid, or manageable loans – helps students complete by reducing their need to work and supporting their time studying and in class. In fact, research shows that students working 15 or more hours a week are more likely to drop out of college than those working fewer hours.[15]

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[13] Bailey, Martha J. and Susan M. Dynarski. 2011. *Gains and Gaps: Changing Inequality in U.S. College Entry and Completion.* National Bureau of Economic Research. Working paper 17633. http://www.nber.org/papers/w17633. U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* Table A-34-1. http://nces.ed.gov/programs/coe/tables/table-trc-1.asp.

[14] Noel-Levitz. 2007. *Access Alert: How the Neediest Students Can Gain Access and Succeed Through Strategic Financial Aid Awarding.* http://bit.ly/XA0gTq. Titus, Marvin A. 2006. *No College Student Left Behind: The Influence of Financial Aspects of a State's Higher Education Policy on College Completion.* The Review of Higher Education, Vol. 29, No. 3.

[15] CALPIRG. 2009. *Working Too Hard to Make the Grade: How Fewer Work Hours and More Financial Aid Can Help California Community College Students Succeed.* http://www.uspirg.org/sites/pirg/files/reports/workingtoohard.pdf. American Council on Education. 2002. *Crucial Choices: How Students' Financial Decisions Affect Their Academic Success.* http://armasineducation.com/documents/crucialchoices.pdf. Orszag, Jonathan M., Peter R. Orszag, and Diane M. Whitmore, commissioned by UPromise, Inc. 2001. *Learning and Earning: Working in College.* http://www.brockport.edu/career01/upromise.htm.

Although more is needed, a great deal of research has explored the effectiveness of different types of financial aid programs. This paper does not provide an exhaustive review of the literature,[16] but highlights key points from the research that should inform policy decisions about redesigning aid programs.

Grant programs have a positive effect on enrollment, persistence, and completion.

Enrollment

Many researchers have studied the effectiveness of grant programs at the federal, state, and institutional levels. A general consensus has emerged that grant aid increases students' likelihood of enrolling in college: on average, each $1,000 of grant aid a student receives increases his or her likelihood of enrollment by about four percentage points.[17] The positive effect of grant aid on enrollment has been documented in studies of several state grant programs, veterans' benefits, and the Social Security Student Benefit Program, and has been particularly pronounced with programs with easy-to-understand eligibility criteria, simple application processes, and outreach efforts to ensure eligible students know about them.[18]

Notably, the federal Pell Grant program has none of these features, which likely explains why research on the effectiveness of Pell Grants on enrollment has been less conclusive.[19] According to Bridget Terry Long, a professor of education and economics at the Harvard Graduate School

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[16] For a detailed review of the research on the effectiveness of different types of financial aid, see: Castleman, Benjamin and Bridget Terry Long. 2012. *Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence, and Graduation*. http://bit.ly/Y0FUCW. Scott-Clayton, Judith. 2012. *Information Constraints and Financial Aid Policy.* National Bureau of Economic Research. Working Paper 17811. http://www.nber.org/papers/w17811. Deming, David and Susan Dynarski. 2009. *Into College, Out of Poverty? Policies to Increase the Postsecondary Attainment of the Poor.* National Bureau of Economic Research. Working Paper 15387. http://www.nber.org/papers/w15387.

[17] Long, Bridget Terry. 2008. *What Is Known About the Impact of Financial Aid? Implications for Policy*. National Center for Postsecondary Research. Working Paper. http://www.eric.ed.gov/PDFS/ED501555.pdf. Deming and Dynarski 2009.

[18] Cornwell, Christopher, David B. Mustard, and Deepa J. Sridhar. 2006. *The Enrollment Effects of Merit-Based Financial Aid: Evidence from Georgia's HOPE Program.* Journal of Labor Economics. Vol. 24, No. 4. http://www.terry.uga.edu/hope/hope.enrollments.pdf. Turner, Sarah and John Bound. 2002. *Closing the Gap or Widening the Divide: The Effects of the G.I. Bill and World War II on the Educational Outcomes of Black Americans.* National Bureau of Economic Research. Working Paper 9044. http://www.nber.org/papers/w9044. Dynarski, Susan. 2000. *Hope for Whom? Financial Aid for the Middle Class and Its Impact on College Attendance.* National Bureau of Economic Research. Working Paper 7756. http://www.nber.org/papers/w7756. Dynarski, Susan M.. 1999. *Does Aid Matter? Measuring the Effects of Student Aid on College Attendance and Completion.* National Bureau of Economic Research. Working Paper 7422. http://www.nber.org/papers/w7422. Brackett, Margaret H., Craig S. Gordon, and Gary T. Henry. 1999. *HOPE Longitudinal Study: Year 2 Results.* Applied Research Center of the Andrew Young School of Policy Studies.

http://www.issuelab.org/resource/hope_longitudinal_study_year_2_results. Bound, John and Sarah E. Turner. 1999. *Going to War and Going to College: Did World War II and the G.I. Bill Increase Educational Attainment for Returning Veterans?* National Bureau of Economic Research. Working Paper 7452. http://www.nber.org/papers/w7452. Angrist, Joshua D. 1990. *The Effect of Veterans Benefits on Veterans' Education and Earnings.* National Bureau of Economic Research. Working Paper 3492. http://www.nber.org/papers/w3492.

[19] Some studies have not found an effect on enrollment, while others found an effect for certain populations. See: Seftor, Neil and Sarah Turner. 2002. *Back to School: Federal Student Aid Policy and Adult College Enrollment.* The Journal of Human Resources. Vol. 37, No. 2. http://bit.ly/VOxmmu. Heller, Donald E.. 1997. *Student Price Response in Higher Education: An Update to Leslie and Brinkman.* The Journal of Higher Education. Vol. 68, No. 6. Long 2008.

of Education, "[T]he most convincing explanations for the lack of a response among low-income students to the Pell Grant focus on problems with the program itself…. researchers suggest that low program visibility, the complexity of the application process, and intimidating audit procedures contributed to limiting the aid program's impact."[20] Making the Pell Grant program simpler and easier to apply for – much like other need-based grant programs that have been shown to have significant effects – would likely increase its effectiveness.[21] The impact of Pell Grants and other grant aid on enrollment may be further undermined and harder to assess because so many low-income students do not realize how much grant aid they are eligible for until *after* they have applied and been admitted to a college. Too many college financial aid award letters do not clearly distinguish grant aid from loans, further reducing the impact of the grant aid on enrollment decisions.[22]

Persistence and completion

Many studies have also found a positive effect of grant aid, and Pell Grants in particular, on persistence and completion. Though low-income students generally have lower success rates than higher income students, studies have found that Pell Grants can help to close the gap, as recipients are more likely to stay enrolled and succeed than low-income students who do not receive grants.[23] Studies of other need-based grant programs have also found that grants help students persist and succeed,[24] with one study documenting that an increase of $1,000 in grant aid in a Pell recipient's first year was associated with a two- to four-percentage-point increase in enrollment in the second year.[25]

The effectiveness of grant aid may be explained in part by its timing. For families with limited resources, financial aid is most helpful when provided at the time students need to pay for college costs. In fact, a recent survey found that over half (52%) of students who dropped out of college did so because they could not afford the tuition and fees.[26] Another study of emergency financial aid programs at community colleges and tribal colleges found that those programs

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[20] Long 2008. Pp 17.

[21] Deming and Dynarski 2009 and Bowen, William G., Matthew M. Chingos, and Michael S. McPherson. 2009. *Crossing the Finish Line: Completing College at America's Public Universities.* Princeton, NJ: Princeton University Press.

[22] For more information, see *TICAS Comments on Draft Financial Aid Shopping Sheet:* http://ticas.org/files/pub/TICAS_comments_on_financial_aid_shopping_sheet.pdf.

[23] Chen, Rong and Stephen L. DesJardins. 2008. *Exploring the Effects of Financial Aid on the Gap in Student Dropout Risks by Income Level.* Research in Higher Education. Vol. 49, No. 1. Bettinger, Eric. 2004. *How Financial Aid Affects Persistence from College Choices: The Economics of Where to Go, When to Go, and How to Pay for It.* National Bureau of Economic Research. Working Paper 10242. http://www.nber.org/papers/w10242.

[24] Bettinger, Eric. 2010. *Need-Based Aid and Student Outcomes: The Effect of the Ohio College Opportunity Grant*. http://www.sesp.northwestern.edu/docs/need-based-aid-why.pdf. Heller, Donald. 2003. *Informing Public Policy: Financial Aid and Student Persistence*. WICHE. http://www.wiche.edu/info/publications/InformingPublicPolicy.pdf.

[25] Goldrick-Rab, Sara, Douglas N. Harris, Robert Kelchen, and James Benson. 2012. *Need-Based Financial Aid and College Persistence: Experimental Evidence from Wisconsin*. http://bit.ly/12iY97R.

[26] Public Agenda. 2009. *With Their Whole Lives Ahead of Them: Myths and Realities about Why So Many Students Fail to Finish College.*

helped students struggling with immediate expenses remain in college.[27] Without access to funds at the time they are needed, low-income students may find their college plans derailed by crucial expenses that need to be paid right away.

Research on other types of aid.

There is less research on the effectiveness of loans or tax credits on student enrollment, persistence, and completion, and the collective findings are less conclusive. However, studies that compare the relative effects of grants, loans, and work-study have found that grants are most effective in increasing the likelihood of enrollment and completion.[28]

Loans

According to recent surveys, student loan debt is a major concern for the general public as well as young adults, lower income parents of color, and engaged voters.[29] At least two-thirds of students who graduated from four-year colleges in 2011 had loans, compared to less than half in 1993.[30] Borrowers in the Class of 2011 owed an average of $26,600.[31] At least 38 million borrowers at all stages of life hold a total of more than $1 trillion in outstanding education loan debt, including federal and private undergraduate, graduate, and parent loans.[32]

Student loans have become a fact of life for more and more Americans as college costs have outpaced both family incomes and available need-based grant aid. This is particularly true for low-income students. Pell Grant recipients – the vast majority of whom have family incomes below $40,000 – are more than twice as likely as other students to have loans.[33] Of those who complete a four-year degree, nine out of 10 Pell recipients have loans, and their average debt at graduation is several thousand dollars more than their higher income peers'.[34] At community colleges, which enroll the majority of low-income and minority students, less than 15 percent of

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[27] MDRC. 2008. *Helping Community College Students Cope with Financial Emergencies Lessons from the Dreamkeepers and Angel Fund Emergency Financial Aid Programs*. http://www.mdrc.org/helping-community-college-students-cope-financial-emergencies.

[28] Li, Dai. 2008. *Degree Attainment of Undergraduate Student Borrowers in Four-Year Institutions: A Multilevel Analysis*. Journal of Student Financial Aid. Vol. 37, No. 3. http://bit.ly/14HbrxP. Moore, Robert L., A.H. Studenmund and Thomas Slobko. 1991. *The Effect of the Financial Aid Package on the Choice of a Selective College*. Economics of Education Review. Vol. 10, No. 4.

[29] For example, see: Hart Research Associates, commissioned by HCM Strategists 2013. Lake Research Partners and Bellwether Research and Consulting, commissioned by TICAS, Dēmos, and Young Invincibles. 2011.

[30] TICAS. 2010. *Quick Facts about Student Debt.* http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources.pdf

[31] TICAS. 2012. *Student Debt and the Class of 2011.* http://projectonstudentdebt.org/files/pub/classof2011.pdf.

[32] U.S. Consumer Financial Protection Bureau. July 19, 2012. Press release. "Consumer Financial Protection Bureau and U.S. Department of Education Joint Report Finds a Cycle of Boom and Bust in Private Student Loan Market." http://1.usa.gov/Y3zLUB . U.S. Department of Education. 2012. *FY 2012 Federal Student Aid Annual Report.* http://www2.ed.gov/about/reports/annual/2012report/fsa-report.pdf. P. 2.

[33] TICAS. 2012. *Pell Grants Help Keep College Affordable for Millions of Americans*. http://ticas.org/files/pub//Overall_Pell_one-pager_11-26-12.pdf

[34] TICAS 2010.

students borrow,[35] but more than a third of community college students who complete associate's degrees do.[36] At for-profit colleges, which enroll a disproportionate share of low-income and underrepresented minority students, almost everyone borrows, regardless of whether they graduate.[37]

While they may not feel that way to students and families, federal student loans are a form of financial aid. These taxpayer-backed loans are intended to keep college within reach when savings, earnings, grants, and scholarships fall short of total college costs. They provide access to credit with capped interest rates, flexible repayment plans, and consumer protections that would not otherwise be available to students. Federal student loans also have to be repaid, and default on one has very severe consequences for borrowers as well as potential costs to taxpayers. As rising student debt and default levels capture headlines, students may be getting signals to avoid student loans at all costs. The costs of avoidance, however, can themselves be high. Students may decide that it is not worth it to pursue college or training after high school. They may go to college in ways that greatly reduce their odds of completion, such as delaying enrollment or re-enrollment, going part time, or working long hours while in school. They may also take on much riskier debt than federal student loans by using credit cards, installment plans, payday loans, or private education loans.

Overall, there is mixed evidence connecting loans with enrollment, persistence, and completion. Some studies show some relationship, particularly for subsidized loans, while others have found no relationship or an unclear one.[38] As with Pell Grants (see discussion above), the complexity of federal loans likely undermines researchers' ability to assess their effectiveness. For example, consider federal subsidized student loans, on which the government pays the interest while the student is enrolled. This subsidy is a substantial financial benefit for recipients, one that saves borrowers thousands of dollars over the life of their loans.[39] However, because most recipients of subsidized loans also receive unsubsidized loans, the subsidy's impact may be blunted as well as harder to assess.

In addition, little is known about the long-term repercussions of loans, including the costs and consequences of defaults and the effects of student debt on behaviors such as family formation, homeownership, and saving for retirement. While such effects can be hard to quantify, one survey found for every $5,000 in student loan debt, the likelihood of owning a home decreased by one percent.[40]

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[35] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[36] The College Board. 2009. *How Much are College Students Borrowing?* http://advocacy.collegeboard.org/sites/default/files/09b_552_PolicyBrief_WEB_090730.pdf.

[37] Ibid.

[38] Singell, Larry D. 2004. *Come and stay a while: Does financial aid effect retention conditioned on enrollment at a large public university?* *http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1011&context=cheri*. Young Invincibles. 2012. *Student Perspective on Federal Financial Aid Reform*. http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf. Long 2008.

[39] For more details, see http://views.ticas.org/?p=753.

[40] Long 2008.

Tax Credits

Federal higher education benefits provided through the tax code have expanded significantly over the last 15 years, almost tripling their share of total federal higher education funding (from 3.6% to 10.5%) between 1997 and 2011. In 2011, more people received some form of higher education tax benefit (13.1 million) than received Pell Grants (9.4 million) or subsidized Stafford loans (10.4 million).[41]

While a number of education tax benefits provide direct financial relief via individual tax credits and deductions, others provide help through incentives for college saving or through the exclusion of grants, scholarships, or employer-provided assistance from taxation. Still other federal education tax provisions provide assistance to institutions, donors, and investors, rather than students and their families. In fact, one-third of the value of all federal education tax benefits (almost $10 billion) went to such recipients in 2011.[42]

Research shows that tax benefits are less effective than grants and loan subsidies at altering behavior, particularly because students and families receive tax benefits long after they have had to pay for the education. In other words, tax benefits go to students and families who have already found a way to pay the up-front costs of college. In contrast, financially needy students unable to cover tuition, books, food, housing, and transportation costs are unlikely to be influenced by the potential for future tax relief, because their focus is on the crucial expenses that need to be paid right away.[43]

In addition, unlike grant aid or subsidized loans, tax benefits disproportionately accrue to upper-middle- and higher income families, whose children are already the most likely to attend and complete college. An estimated 93 percent of those eligible for higher education tax benefits would have enrolled in college without them.[44] In contrast, research has shown that the most effective financial aid is targeted to students who would otherwise be unlikely or unable to enroll in or complete college, such as moderate- and low-income students.[45]

Lastly, the current higher education tax benefits are complex, confusing, and duplicative. It takes the Internal Revenue Service (IRS) 87 pages to explain them all and how they do and do

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[41] College Board. 2012. *Trends in Student Aid 2012*. http://trends.collegeboard.org/student-aid. Figure 7a.

[42] Calculations by the Center on Budget and Policy Priorities on data from the Joint Committee on Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015*, https://www.jct.gov/publications.html?func=startdown&id=4386.

[43] Long, Bridget T. 2004. "The Impact of Federal Tax Credits for Higher Education: College Choices: The Economics of Where to Go, When to Go, and How to Pay For It." Pp. 101-168 in *College Choices: The Economics of Where to Go, When to Go, and How to Pay For It*, edited by Caroline M. Hoxby. Chicago, IL: University of Chicago Press. http://www.nber.org/chapters/c10099.pdf.

[44] Turner, Nicholas. 2010. *The Effect of Tax-Based Federal Student Aid on College Enrollment*. National Tax Journal. Vol. 64, No. 3. http://bit.ly/XsjNU1.

[45] Center on Budget and Policy Priorities. 2012. Unpublished memo. Also see: Heller 1997. Dynarski, Susan. Testimony before the U.S. Senate Committee on Finance. Delivered July 25, 2012. Center on Budget and Policy Priorities. 2007. *Making Higher Education Tax Credits More Available To Low- And Moderate-Income Students: How and Why.* http://www.cbpp.org/cms/?fa=view&id=265. U.S. Department of Education. 2011. F*ederal Education Tax Benefits: Who Receives Them and to What Extent Do They Shape the Price of College Attendance? http://nces.ed.gov/pubs2012/2012212.pdf*. Long 2004.

not interact.[46] A recent Government Accountability Office (GAO) report to Congress found that over *half* of all tax filers likely eligible for a higher education benefit failed to claim one at all or chose a less optimal benefit than they were qualified for.[47]

Ultimately, the timing, targeting, and complexity of existing higher education tax benefits render them less efficient and effective than other aid at increasing enrollment and completion. Moreover, to the extent that tax benefits might be offset by a reduction in grant aid, as one study found, they are not only inefficient at increasing enrollment and completion, but ineffective at reducing cost for the recipient.[48]

Improvement in financial aid programs is desperately needed.

Based on our review of available research, there are a number of areas where financial aid programs need major improvement to be more effective in increasing college access and success. In particular:

- Available need-based grant aid is insufficient to overcome gaps in access and success.
- Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.
- The complexity of the current federal aid application process and programs undermines their effectiveness.
- Colleges and states are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.
- Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

Available need-based grant aid is insufficient to overcome gaps in access and success.

Though the cost of tuition and fees typically generates the most interest from policymakers, media, and the public alike, students also have to cover the full cost of attendance, which includes books, housing, food, and transportation. Although eligibility for many types of financial aid is based on the full cost of attendance, many needy students still end up with a gap

[46] The IRS guidance on education tax benefits for 2011 is 87 pages. See IRS Publication 970 at http://www.irs.gov/pub/irs-pdf/p970.pdf.

[47] White, James R. and George A. Scott, U.S. Government Accountability Office (GAO). "Higher Education: Improved Tax Information Could Help Families Pay for College." Testimony before U.S. Senate Committee on Finance. Delivered on July 25, 2012. http://www.gao.gov/products/GAO-12-863T.

[48] Turner, Nicholas. 2010. *Who Benefits From Student Aid? The Economic Incidence of Tax-Based Federal Student Aid.* http://www.escholarship.org/uc/item/7g0888mj.

between available resources and the cost of attendance. As noted earlier, research has shown this unmet need to negatively influence the likelihood of enrolling in and completing college.[49]

Fully three-quarters of full-time undergraduate students have some amount of unmet need that they must find a way to cover with loans or earnings from working while enrolled. Lower income students are the most likely to have unmet need: 99 percent of full-time students who receive a Pell Grant have an average of $12,000 left to cover after taking all grants into account, and 86 percent of Pell Grant recipients still have an average of $8,500 unmet after subtracting federal loans and work-study.[50] How individual students cover these costs varies, but many do so in ways that jeopardize their educational or financial future, such as working multiple jobs while enrolled full time or taking out risky private student loans.

While recent increases to the maximum Pell Grant have been important steps forward, they have been insufficient to stop the decline in the grant's purchasing power. The maximum grant in 2012-13 covers the lowest share of college costs since the start of the program, representing less than one-third (31%) of what it costs to attend a public four-year college. This is less than half of the purchasing power the grant had in the late 1970s, when it covered between 69 and 84 percent of costs.[51] When Pell Grants cover smaller shares of costs, students end up paying for the difference using loans or work, taking fewer courses, or dropping out.

In a 2008 working paper documenting the extent of unmet need and its implications for financial aid policy, Bridget Terry Long states:

> Given these patterns of unmet need, questions about the effectiveness of the current system of financial aid often focus on whether current amounts are adequate…. Although billions of dollars are spent each year on financial aid, the above unmet need figures suggest the current amount of funding may not be enough…. Reviews of the research literature should keep in mind this reality and consider how inadequate funding levels may limit the effectiveness of current forms of aid. However, decisions about the best ways to expand the aid system should be principally guided by what is known about the particular designs and types of aid that are most effective.[52]

Investing in ineffective programs is a poor use of resources, but insufficient investment can render even the best programs ineffective. We need to deepen our investment in need-based grant aid, along with requiring that states and colleges do their share, to help close income gaps in college access and success.

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[49] Noel-Levitz 2007 and Titus 2006.

[50] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[51] College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, 2012, *Trends in College Pricing 2012*, Table 2, http://bit.ly/14OJvbv, and U.S. Department of Education data on the maximum Pell Grant.

[52] Long 2008.

Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.

There is widespread confusion about college costs and the availability of financial aid, which can lead students and families to inadvertently choose colleges they cannot afford, or price themselves out of higher education when it is actually within their reach. Students and families have been found to overestimate the cost of college[53] and a recent survey found that a majority of students rule out colleges based on "sticker price" alone, without considering financial aid.[54] Notably, students from lower- and middle-income families are more likely than affluent students to rule out colleges based on published prices. In another recent survey, half of low-income families eliminated colleges based on cost before doing any research on them.[55]

The lack of high-quality and meaningful data on cost and aid is a problem. Recent efforts to provide early estimates of college costs and financial aid eligibility have been a step in the right direction, but still have room for substantial improvement. For instance, almost all U.S. colleges and universities are now required to have "net price calculators" on their websites to help students and their families understand how much they would have to earn, save, or borrow to go to that school. Although these tools have promise, many net price calculators are not currently easy for prospective students to find, use, and compare.[56]

In addition to the inadequacy of early estimates of financial aid, there is a lack of clear and meaningful information from colleges about aid and student outcomes. Existing disclosure requirements are often ineffective, in part because they are frequently ignored by colleges or met in a way that confounds rather than enlightens consumers.[57] Further, holes in available data make it difficult or even impossible to learn about cumulative debt or job placement rates for colleges or programs.[58] These are critical questions for students considering a college, but data limitations prevent them from finding meaningful and comparable answers.

This lack of information is a problem because there is such wide variation in college costs and college outcomes, and higher cost colleges do not always deliver the best outcomes. For

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[53] Grodsky, Eric and Melanie Jones. 2004. *Real and Imagined Barriers to College Entry: Perceptions of Cost.* Social Science Research. Vol. 36. U.S. Department of Education. 2003. *Getting Ready to Pay for College: What Students and Their Parents Know About the Cost of College Tuition and What They Are Doing to Find Out.* http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2003030.

[54] The College Board and Art & Science Group, LLC. 2012. *A Majority of Students Rule Out College Based on Sticker Price: Students Do Not Take into Account Their Likely Financial Aid Award and Its Impact on Net Cost.* Student Poll Vol. 9, Issue 1. http://www.artsci.com/studentpoll/v9n1/index.html.

[55] Sallie Mae. 2012. *How America Pays for College 2012*. http://bit.ly/WV5wzT.

[56] TICAS. 2012. *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* http://ticas.org/files/pub/Adding_It_All_Up_2012.pdf.

[57] The American Enterprise Institute and Education Sector. 2011. *The Truth Behind Higher Education Disclosure Laws.* http://www.aei.org/files/2011/11/07/-truthhighereddisclosurelaws_185621335060.pdf.

[58] U.S. Department of Education, National Postsecondary Education Cooperative. 2011. *Suggestions for Improvements to the Collection and Dissemination of Federal Financial Aid Data*. http://nces.ed.gov/pubs2012/2012834.pdf. See also the White House College Scorecard, a one-page snapshot intended to "make it easier for students and their families to identify and choose high-quality, affordable colleges that provide good value." Multiple sections of the scorecard are blank due to lack of data: http://www.whitehouse.gov/issues/education/higher-education/college-score-card. Accessed January 18, 2013.

example, many of the colleges that charge low-income students the most have low graduation rates. In fact, more than 94 percent of low-income students at for-profit colleges attend schools where they have to contribute more than 100 percent of their average household income (about $17,000) and have a less than a one-in-four chance at graduating.[59] They may not have known that better and more affordable options are available.

Research shows that providing students and families with clear information about costs and outcomes can help them make better decisions about college. Getting information about costs and financial aid has been found to increase students' and parents' college-going aspirations,[60] and adding graduation rates to comparisons of two otherwise similar colleges can have an impact on parent preferences.[61] Further, students who write off selective colleges based on sticker price may undermine their chances of earning a degree by "undermatching," or choosing a less selective college than they are academically qualified to attend.[62] Providing the information students and families need to make meaningful comparisons supports their ability to find the college that is the best fit, increasing the probability that students thrive and graduate.

The complexity of the current federal aid application process and programs undermines their effectiveness.

As a result of the complexity of our current financial aid system, students are missing out on aid they would likely be eligible for. Nationally, an estimated 2.3 million students were eligible for a Pell Grant but did not complete the Free Application for Federal Student Aid (FAFSA) in 2007-08.[63]

The FAFSA is universally criticized for being too complex, and understandably so. With only slightly fewer questions than the full 1040 federal income tax form,[64] the sheer number and detail of required questions in the FAFSA can be daunting, particularly for students who are least familiar with the financial aid process. The relatively new IRS Data Retrieval tool is an

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[59] The Education Trust 2011.

[60] Oreopoulos, Philip and Ryan Dunn. 2012. *Information and College Access: Evidence from a Randomized Field Experiment.* National Bureau of Economic Research. Working Paper 18551. http://www.nber.org/papers/w18551. The College Board Advocacy & Policy Center. 2010. *Cracking the Student Aid Code: Parent and Student Perspectives on Paying for College*.

http://advocacy.collegeboard.org/sites/default/files/11b_3172_Cracking_Code_Update_WEB_110112.pdf. Zarate, Maria Estela and Harry P. Pachon. 2006. *Perceptions of College Financial Aid Among California Latino Youth*. Los Angeles, CA: Tomas Rivera Policy Institute (TRPI).

[61] American Enterprise Institute. 2011. *What Parents Don't Know about College Graduation Rates Can Hurt.* http://bit.ly/W2GMYd.

[62] Bowen, Chingos, and McPherson 2009. The University of Chicago Consortium on Chicago School Research. 2009. *From High School to the Future: Making Hard Work Pay Off.* http://ccsr.uchicago.edu/publications/high-school-future-making-hard-work-pay.

[63] Kantrowitz, Mark. 2009. *Analysis of Why Some Students Do Not Apply for Financial Aid.* *http://www.finaid.org/educators/20090427CharacteristicsOfNonApplicants.pdf*.

[64] Dynarski, Susan and Mark Wiederspan. 2012. *Student Aid Simplification: Looking Back and Looking Ahead*. National Bureau of Economic Research. Working Paper 17834. http://www.nber.org/papers/w17834.

important step forward in simplifying the application process, but it still has major limitations and needs improvement before it can be used by all applicants.[65]

Simplifying the aid application process can have a large effect on enrollment and the receipt of financial aid, which in turn affects persistence. An experimental program conducted in partnership with H&R Block found that students who have more information about aid and receive assistance completing the FAFSA are substantially more likely to submit the aid application, enroll in college the following fall, and receive more financial aid than those who do not receive assistance and information.[66] Specifically, the program increased enrollment among high school seniors, recent high school graduates, and low-income adults with no prior college experience.

Importantly, research shows that the FAFSA can be simplified without serious negative side effects on targeting or eligibility for other aid programs. A recent analysis found that most of the questions on the FAFSA could be eliminated and the process aligned to IRS tax returns without losing very much in terms of targeting the aid to needy students.[67] Another analysis suggests that FAFSA simplification would have only a minimal effect on students' eligibility for state financial aid.[68] Simplifying the FAFSA, particularly through further improvements to the IRS data transfer, would also reduce burden for colleges and universities by streamlining the verification process.[69]

Further, as discussed earlier, the complexity of federal grants, loans, and tax credits confuses students and families and blunts the impact of those programs. Students cannot respond to a benefit that they do not know about, and cannot make optimal choices without understanding their options. This complexity also confounds researchers seeking to document the effectiveness of federal aid expenditures.

Colleges and states are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.

Current federal policies hold students accountable for studying hard and making continued progress toward their educational goals.[70] To maintain eligibility for federal financial aid,

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[65] For more information, see TICAS' comments to the U.S. Department of Education on the proposed 2011-12 FAFSA materials: http://www.ticas.org/files/pub/2011-12_Federal_Student_Aid_Application_comments_15Nov2010.pdf.

[66] Bettinger, Eric, Bridget Terry Long, Philip Oreopoulos, and Lisa Sanbonmatsu. 2009. *The Role of Simplification and Information in College Decisions: Results from the H&R Block FAFSA Experiment.* National Bureau of Economic Research. Working Paper 15361. http://www.nber.org/papers/w15361.

[67] Dynarski and Wiederspan 2012, building. Dynarski and Wiederspan 2012 built upon previous work by Dynarski, Susan, and Judith Scott-Clayton, 2006. *The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics*. National Tax Journal Vol. 59, No. 2.

[68] The College Board. 2012. *Simplifying Student Aid: What It Would Mean for States.* http://advocacy.collegeboard.org/sites/default/files/12b_5073_State_Simplicication_Report_FINAL.pdf.

[69] For more information, see TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid.* http://ticas.org/files/pub/AfterFAFSA.pdf.

[70] For more information, see TICAS. 2011. *Pell Grant Provisions Prevent Student Abuse.* http://ticas.org/files/pub/Protections_against_Pell_abuse_one-pager_July_18-_updated.pdf.

students must make "satisfactory academic progress" (SAP). Under federal SAP guidelines, which were strengthened in 2011, students must complete at least two out of every three units attempted with a grade of "C" or better, and colleges must assess all federal aid applicants to ensure that they are making adequate progress toward a credential for students to receive federal aid. College guidelines may be stricter. Federal rules also require students who either drop out or drop most of their courses after receiving federal aid to repay what they did not earn—and they are not eligible for more aid until they do.

However, there are few consequences for schools that fail to graduate large shares of students or leave students with excessive debt and/or degrees that have little value in the job market. Particularly in an era of limited resources, the federal government should not distribute financial aid dollars to poorly performing schools. The data are clear that some schools have a much better track record than their peers of enrolling and graduating low-income students, while maintaining a manageable cost.[71] Attaching better accountability measures to institutional eligibility for federal financial aid can help redirect resources efficiently and incentivize schools to improve outcomes for their students.

Student outcomes vary considerably, even among similar colleges. For example, among open-admission colleges, where all applicants are admitted, graduation rates vary greatly from school to school and sector to sector. A 2010 report by The Education Trust found that the graduation rates at open-admission four-year for-profit colleges were on average about three times lower than the rates at open-admission public and nonprofit four-year colleges (11% compared to 31% and 36%, respectively).[72] This is particularly problematic because students attending for-profit colleges are more likely to borrow than students attending other types of colleges.[73]

Recent efforts to increase accountability for colleges have not been sufficient. In particular:

- In 2008, Congress strengthened the calculation of colleges' "cohort default rates" (CDRs), which measure how many of a college's borrowers default, or fail to make any payments on their loans for at least nine months, within a certain period of time after they leave school. Congress strengthened the calculation by extending the period of time during which borrowers were tracked, from two years to three years, while moderating the impact by raising allowable default levels.[74] However, some colleges are taking steps to

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[71] The Education Trust 2011.

[72] The Education Trust. 2010. *Subprime Opportunity: The Unfulfilled Promise of For-Profit Colleges and Universities.* http://www.edtrust.org/sites/edtrust.org/files/publications/files/Subprime_report_1.pdf. This study measured six-year graduation rates at four-year colleges.

[73] Abernathy, Pauline. TICAS. Testimony before the U.S. Senate Health, Education, Labor, and Pensions Committee Hearing on "Drowning in Debt: Financial Outcomes of Students at For-Profit Colleges." Delivered June 7, 2011. http://projectonstudentdebt.org/files/pub/Abernathy_testimony_June_7_2011.pdf.

[74] U.S. Department of Education, Office of Postsecondary Education. 2008. *The Higher Education Act*. DCL GEN-08-12. http://www.ifap.ed.gov/dpcletters/GEN0812FP0810.html.

mask high default problems and manipulate their default rates in ways that help colleges, not students.[75]

- The U.S. Department of Education's (the Department's) final "gainful employment" rule, issued in June 2011,[76] was substantially weaker than the draft rule and is currently on hold due to a court ruling.[77] This rule would have enabled enforcement of longstanding federal law requiring postsecondary career education programs (offered at public, nonprofit, and for-profit colleges) receiving federal financial aid to "prepare students for gainful employment in a recognized occupation."

States as well as colleges must also be held more accountable to ensure that they are adequately supporting their students. More than three-quarters of undergraduate students (76%) attend public colleges, which awarded 75 and 64 percent of associate's and bachelor's degrees, respectively, in 2010.[78] Because public higher education is primarily funded and managed at the state level, federal policy intended to affect college affordability and student debt levels must also take into account state-level funding policy. A decades-old trend of state disinvestment in public higher education accelerated dramatically during the economic crisis. Per-student state funding at public institutions fell more than 25 percent from 2007 to 2011 and is currently at its lowest level in over 25 years.[79] This sharp decline in public subsidy levels has been the largest driver of recent tuition increases at public institutions,[80] which have significantly decreased affordability and increased student debt.[81]

Given state funding trends,[82] federal maintenance of effort (MOE) provisions, which tie certain amounts of federal support to a required minimum level of state investment, have become a powerful way to encourage states to maintain funding for higher education. MOE provisions were included in the American Recovery and Reinvestment Act (ARRA) State Fiscal

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[75] TICAS. 2012. *Steps the Education Department Should Immediately Take to Curb Default Rate Manipulation.* http://ticas.org/files/pub/TICAS_memo_on_CDR_evasion_082112.pdf.

[76] U.S. Department of Education. June 2, 2011. Press release. "Obama Administration Announces New Steps to Protect Students from Ineffective Career College Programs. Gives Programs Every Chance to Improve While Holding Them Accountable." http://www.ed.gov/news/press-releases/gainful-employment-regulations.

[77] TICAS. July 2, 2012. Blog post. "Court Strikes Down Low "Gainful Employment" Repayment Rate Standard but Affirms Education Department's Authority to Act and the Need to Do So." http://views.ticas.org/?p=884.

[78] U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* "Indicator 46: Degrees Conferred by Public and Private Institutions." http://nces.ed.gov/programs/coe/pdf/coe_dai.pdf. U.S. Department of Education, National Center for Education Statistics. 2012. *The Condition of Education 2012.* "Indicator 36: Characteristics of Undergraduate Institutions." http://nces.ed.gov/programs/coe/pdf/coe_psi.pdf.

[79] Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012,* Figures 12A and 12B. http://trends.collegeboard.org/sites/default/files/CP%20Figure%2012AB%20011013_0.xlsx.

[80] Delta Cost Project at the American Institutes for Research. 2012. *Spending, Subsidies, and Tuition: Why are Prices Going Up? What are Tuitions Going to Pay For?* http://www.deltacostproject.org/resources/pdf/Delta-Subsidy-Trends-Production.pdf. Figure 3.

[81] TICAS. 2012. *Student Debt and the Class of 2011.* http://projectonstudentdebt.org/files/pub/classof2011.pdf.

[82] Although the most recent Grapevine survey of state support for public higher education in 2012-13 shows a slowing of the average reduction in support for higher education, the large hole between previous and current levels of support remains and it is expected that the "new normal" for state funding of higher education will take a long time to reverse, if ever. For more information, see http://live.sheeo.gotpantheon.com/sites/default/files/publications/Grapevine_Release_FY13_Jan16.pdf.

Stabilization Fund in 2009 and in the Education Jobs Fund in 2010 and were widely seen as effective in protecting higher education funding from even deeper state funding cuts that would have otherwise occurred, with 15 states cutting funding to within one percent of the federally required minimum funding level during the years the requirements were in effect.[83]

Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

There is tremendous room for improvement in the way that changes are proposed and made to financial aid programs. Too many financial aid policy changes are adopted based on the short-term savings they produce, with too little focus on their impact on students, unintentionally undermining the goals of college access and success.

As a case in point, consider the recent creation of a retroactive, six-year lifetime eligibility limit for Pell Grants.[84] In 2008, Congress limited Pell Grant eligibility to nine years and applied the limit prospectively - to students receiving a Pell Grant for the first time on or after July 1, 2008.[85] In December 2011, after virtually no public deliberation, Congress lowered this lifetime limit to six years and applied it *immediately and retroactively* to all students, including those a semester away from completing their degrees.[86] Because this change was applied retroactively, students did not have an opportunity to adjust their behavior and many were left scrambling to try to replace the financial aid funds they had been counting on.

Based on data from the Congressional Budget Office (CBO), during the 2012-13 year alone this immediate and retroactive lifetime limit made more than 100,000 students permanently ineligible for a Pell Grant. This change is expected to disproportionately harm African-American students and students enrolled at public and nonprofit four-year colleges, and will make it harder for students who were required to take remedial or developmental courses to complete.

Recent reports have already begun to quantify the impact at the state and college levels. In Alabama, the new lifetime eligibility limit led to an estimated 4,731 public college students losing their Pell Grants in fall 2012.[87] Another 12,057 Alabama students will likely lose Pell Grant eligibility in the next two semesters. In Mississippi, the new lifetime eligibility limit, along with two other changes to the Pell Grant program, led to enrollment decreases at 14 out of 15 of

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[83] American Association of State Colleges and Universities (AASCU). 2012. *Update on the Federal Maintenance of Effort Provision: Reinforcing the State Role in Public Higher Education Financing*. http://www.aascu.org/policy/publications/policy-matters/2012/MaintenanceofEffort-II.pdf.

[84] For more information, see *Impact of the Immediate and Retroactive Lower Lifetime Limit for Pell Grants:* http://ticas.org/files/pub/Retroactive_6yr_Pell_lifetime_limit_06-19-12.pdf.

[85] Higher Education Opportunity Act. Public Law 110-315, August 14, 2008. http://www.gpo.gov/fdsys/pkg/PLAW-110publ315/pdf/PLAW-110publ315.pdf

[86] Consolidated Appropriations Act 2012, Public Law 112-74, http://www.gpo.gov/fdsys/pkg/BILLS-112hr2055enr/pdf/BILLS-112hr2055enr.pdf.

[87] Katsinas, Stephen, Nathaniel Bray, Jonathan Koh, and Phillip Grant, commissioned by the Alabama Commission on Higher Education. 2012. *A Study of Pell Grants in Alabama.* http://1.usa.gov/VKYNh4.

the state's community colleges in fall 2012.[88] Almost 3,000 Mississippi students lost Pell Grant eligibility in fall 2012 and more than 7,000 more are expected to lose eligibility in the next several semesters. Community colleges in other states are also reporting enrollment declines and students losing part or all of their grants.[89] As Mississippi State Senator Terry Burton (R-Newton), the vice chairman of the state's Senate Universities and Colleges Committee, commented, "When someone runs out of money on a grant eight hours before they've finished a degree, that's bad for them, bad for the university, bad for everybody."[90]

Unfortunately, this form of policymaking – generate savings first and assess impacts later – is not uncommon. In recent years, the economic downturn has contributed to a climate where the need for near-term savings has driven policy discussions, pushing the long-term need for investment in higher education and financial aid into the backseat. Examples of harmful policy proposals at the state and federal levels that were considered and, unlike the retroactive lifetime limit discussed above, not enacted, include:

- **Redefining "full time" for Pell Grants.**[91]
  During budget negotiations in the summer of 2012, some suggested requiring students to take 15 credits, rather than 12 credits, to be considered "full time" and thus be eligible for the maximum Pell Grant. This change would have reduced college access by cutting millions of students' grants by up to $1,400 a year. Purportedly intended to increase college completion, this proposal did not take into account students' inability to take 15 credits per term due to course capacity constraints, work and family commitments, and other restrictions.

- **Instituting an income cap for Pell Grants that ignores family size.**[92]
  The House Fiscal Year 2013 budget resolution proposed implementing an unspecified maximum income cap for Pell Grants, above which students would no longer be eligible for Pell Grants, regardless of their family size or situation. However, the federal needs analysis formula already targets Pell Grants toward the neediest students. A maximum income cap would have simply cut off Pell Grants to needy students from large families.

- **Ratcheting up merit criteria for California's Cal Grants.**[93]
  In his 2012-13 budget proposal, California Governor Jerry Brown recommended

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[88] Quoted in Lane 2013.

[89] Snyder, Susan. January 11, 2013. "Pell grant changes hit community college students hard." *Philadelphia Inquirer.* http://articles.philly.com/2013-01-11/news/36260519_1_pell-grants-pell-eligibility-financial-aid/.

[90] Quoted in Lane, Emily. January 10, 2013. "New Pell Grant restrictions resulted in lower enrollment at 14 of the state's 15 community colleges." *Clarion Ledger.* http://on.thec-l.com/V3jkuJ.

[91] For more information see *Redefining "Full-Time" for Pell Grants Reduces College Access:* http://www.clasp.org/admin/site/documents/files/Redefining-Full-Time-for-Pell-Grants-Reduces-College-Access.pdf.

[92] For more information, see *An Arbitrary Maximum Income Cap Would Eliminate Pell Grants for Needy Students:* http://ticas.org/files/pub//Max_income_cap_for_Pell_in_House_FY13_Budget_07-15-12.pdf. For analyses of other recent Pell Grant proposals, see http://ticas.org/pellgrant_resources.vp.html.

[93] For more information, see *Cal Grant GPA Increases Would Hurt College Completion Rates:* http://ticas.org/files/pub/CG_GPA_Increase_3-06-12.pdf.

substantially raising the grade point average (GPA) thresholds required to receive new Cal Grants. This change would have locked out more than a third of applicants currently eligible for the main type of grant - particularly those whose college access and success are most likely to be enhanced with a Cal Grant. This proposed change was not based on adequate evidence, overlooked major unintended consequences, and would have hit low-income and underserved students the hardest. It was eventually dropped from the California budget.

Rethinking federal student aid to prioritize student access and success requires that we reexamine how financial aid policies are considered, implemented, and modified. A well-designed system of financial aid promotes access and success through a combination of informational and financial supports, built upon each other to enable all willing students to seek and complete a postsecondary credential. Changes made in a vacuum serve to undermine the effectiveness of such a system. Moving forward, we must reject shortsighted policy changes that put savings first and students last.

Principles for federal student financial aid reform.

The following principles are based on our analysis of the existing research and evidence, which is summarized above. The policy recommendations in this white paper are based on these principles.

Affordable. Federal aid should ensure that all students willing to study hard can afford to go to college.

Shared Accountability. Federal aid should hold students accountable for studying hard and making continued progress towards their educational goals, *and* should hold states and schools accountable for ensuring that their students receive a quality education and can complete without burdensome debt.

Adequate and Effective Investment. Federal investments need to be both adequately funded and effectively structured to maximize student access and support success.

Simpler. Federal aid needs to be easy for students to understand and use, and minimize the administrative burden on schools.

Better Information. Clear and timely information about costs, aid, and outcomes is necessary for students to make wise college decisions and to foster competition among colleges to keep costs down.

Timing Matters. To best support access and success, aid should be provided when students need to pay for college costs rather than after the fact.

How Changes are Made. Changes in federal aid policies should be:

- Designed to prioritize access and success for financially needy students.
- Grounded in relevant evidence.

- Made in the open after public deliberation and input.
- Made with great care if the potential harm to students is significant.
- Designed to minimize the risks of waste, fraud, and abuse.

Section 2: Student Eligibility and Accountability

How students and their families find out about, apply for, and qualify for aid all have direct implications for both access and success. As discussed more in Section 1, if they do not know they are eligible for aid, or for how much, they may assume they cannot afford college or that there is no point in applying for aid. However, knowing they are probably eligible for a certain amount of aid is not enough. If the application process is daunting, they may not receive the aid that could help them start and stay in school. In addition, the parameters used to determine eligibility have implications for early awareness, the application process, the distribution of available aid, and how aid recipients are held accountable. There are clear opportunities for improvements to both the application process and the parameters used.

It is important to note that there is no perfect system for determining just how much someone can or should pay for college, or how much aid they should receive. The "needs analysis" formula used to determine federal aid eligibility is an attempt to *predict* what students and their families will be able to afford when they actually have to pay the bills. In some cases, attempts to draw fine distinctions between the poor and the very poor create the highest barriers for those with the greatest financial need and the least support for getting through the process.

The complexity of the Free Application for Federal Student Aid (FAFSA) reflects the complexity of the federal needs analysis formula, but it is possible to simplify the application process regardless of the formula. An analogy is that a word-processing program can be very easy to use even if the underlying code is extremely complex. When considering aid reform, it is imperative to separate these two related but distinct issues: the complexity of the *application process*, which influences how students learn about, apply for, and qualify for aid; and the complexity of the *needs analysis formula*, which serves to direct available aid to specific applicants. We recommend improvements to both below.

To better ensure access and support success, we propose the following reforms to simplify the aid application process and better target available aid, as well as support early awareness:

- Simplify the aid application process
    - Calculate aid eligibility using the tax or W-2 data available when students typically apply to college.

- Streamline the verification process to increase the odds that qualified students receive the aid they applied for.

- Better target available aid and prevent fraud
    - Increase the share of questions that can be answered automatically with Internal Revenue Service (IRS) data.
    - Adjust elements of the needs analysis formula to improve aid targeting.
    - Strengthen student accountability measures that support persistence and completion.

Simplify the aid application process.

There have been tremendously positive changes to the online FAFSA in recent years. Millions of applicants have been able to electronically transfer their tax information into the FAFSA, a system based on our 2007 recommendations for simplifying the aid application process.[94] With the applicant's consent, the IRS Data Retrieval Tool can prepopulate and update answers to more than 20 high-stakes questions on the 2013-14 FAFSA. And once an applicant is identified as an independent student, "skip logic" eliminates additional questions aimed at determining dependency status or collecting parental information.

While the IRS Data Retrieval Tool has been instrumental in streamlining the FAFSA completion process for many students and parents, further improvements are needed to better serve all applicants.

Calculate aid eligibility using the tax or W-2 data available when students typically apply to college.

Currently, FAFSAs for the 2013-14 academic year require applicants' tax data from 2012. This causes several significant timing problems with the current application process, which make it harder for students to get the aid they need and make informed decisions about college. They involve misalignments on multiple fronts: the date that the FAFSA first becomes available; the data it currently requires; and the various deadlines for applying to college, applying for state grants and other types of aid, filing federal income tax forms, and making final choices about which college to attend.

Fixing these timing problems would improve access to needed aid and support more informed decisions about where to go to college and how to pay, and they can all be reduced or eliminated by adjusting the tax year used to predict a student's ability to pay to an earlier year (e.g. using 2011 tax data for academic year 2013-14, instead of 2012 tax data). The table below details how such a change would help to solve a number of well-documented timing problems.

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[94] For more information, see TICAS. 2007. *Going to the Source: A Practical Way to Simplify the FAFSA*. http://www.ticas.org/pub_view.php?idx=232.

Current Timing Problem	The Improved Timing Solution
You cannot apply for federal student aid until January of the coming academic year, even though college applications may be due earlier. For example, the FAFSA for 2013-14 was not available until January 1, 2013 because it requires tax data from the year that just ended. Meanwhile, many four-year college applications were due by December 31, 2012. That means many students decided whether and where to apply to college without knowing if they qualified for federal aid.	Students and families could apply for aid before or when they apply to college. With earlier and more robust aid estimates, aid application and determination could potentially happen as soon as spring of a high school student's junior year.
While you can apply for aid as soon as January 1, the process currently requires tax information from the year that just ended. Employees may not get their W-2 forms until the end of January, and federal tax returns are not due to the IRS until mid-April. However, many state grant programs have deadlines that fall well before federal taxes are due (e.g., Connecticut's is February 15, California's is March 2), and some sources of state and college aid are first-come, first-served.	With earlier access to the requisite tax data, students could more easily meet deadlines for state grants and other sources of aid.[95]
Applicants can use estimates to submit a FAFSA while waiting until their tax return is filed, but they will not be able to confirm aid eligibility or amounts until they update the information. They may also be subject to verification procedures that create further delays and obstacles to receiving the aid they qualify for.	Having readily available tax data would eliminate the need to use estimates on the FAFSA. Financial aid counselors could spend less time verifying students' eligibility and more time helping students navigate the aid process, advising them about their options, and assessing whether recent changes in financial circumstances affect their eligibility for aid.
The IRS Data Retrieval Tool only helps applicants whose required tax information is already in the IRS' electronic records. It can take up to two weeks for an electronically filed 1040 form to become available for data retrieval, and up to eight weeks if the 1040 was filed on paper.	Tax data would be readily available for electronic transfer when students first apply, increasing successful use of the IRS Data Retrieval Tool. By reducing the need for estimation, updating, and verification, this simplifies the FAFSA and reduces uncertainty for students while also reducing administrative burdens for schools. It is estimated to cost schools an average of more than $100 to put a student through verification.[96]
Currently, people who do not file a 1040 because they earn too little to owe federal income tax face the largest paperwork burden when they apply for federal student aid. They do not benefit from the IRS Data Retrieval Tool because it draws information only from 1040 forms. While the IRS can send "W-2 transcripts" to colleges for verification purposes, W-2 data cannot currently be used in the IRS Data Retrieval Tool. One of the possible reasons for this omission is that W-2 data may take longer than 1040 data to become available.	Using a readily available year of tax data for the FAFSA would allow the very lowest income students to benefit from a streamlined application process.

[95] To benefit from this change, some states may need to change their state aid program rules to better align with the federal application process, as discussed below.

[96] TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid.* http://ticas.org/files/pub/AfterFAFSA.pdf.

Each of these problems is distinct, but they share the same solution: using an earlier – and therefore readily available – year of tax data to estimate students' and families' ability to pay college costs. Doing so will let students apply for aid earlier and better understand their eligibility before they and their families make decisions about whether and where to apply to college. It will also improve the process for the lowest income applicants, who are most likely to be targeted for verification, and increase their chances of receiving the aid for which they are eligible. Using an earlier year of data could also help clear the way for non-tax-filers' W-2 income information to be electronically transferred into the FAFSA as tax-filers' income information already is. We strongly recommend allowing non-tax-filers to benefit from the Data Retrieval Tool in this way.

Using the data available in the fall will greatly simplify the aid application process while still effectively targeting aid. Analyses have found that using the earlier year of data (sometimes referred to as "prior-prior year") instead of the year currently used (often referred to as "prior year") would have minimal effects on Pell eligibility for most applicants.[97] Still, even the current system of using prior year data does not create perfect estimates of families' ability to pay. Historical tax data simply cannot be used to predict with total accuracy the resources students and families will actually be able to put towards college during the next academic year. However, evidence suggests that prior-prior income is nearly as good as doing so as prior year income. A U.S. Department of Education (Department) analysis of financial aid applications found that prior-year income was 87 percent predictive of current year income, and prior-prior year income was close at 82 percent.[98]

The increased efficiency and resulting access to aid outweigh the minor eligibility changes that would occur from using an earlier year of data. College financial aid offices would retain their authority to use their professional judgment and draw on more recent income information in cases where students flag substantial changes. In addition, using readily available data for all applicants would free up more of administrators' time to make such adjustments when needed, as fewer students would need assistance with estimating income information before it is available and then updating it after taxes are filed.

This change also has implications for states and colleges, which use students' tax data to allocate state and institutional financial aid.[99] For students to fully realize the benefits of this simplification, states and colleges would need to use the same year of income data as the FAFSA. Otherwise, applicants would have to provide double the amount of information they currently do (two years of information rather than one). Congress and the Department should consider how to best incentivize states to adjust their aid programs that are not already tied to whatever the FAFSA uses.

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[97] Dynarski, Susan and Mark Wiederspan. 2012. *Student Aid Simplification: Looking Back and Looking Ahead*. National Bureau of Economic Research. Working Paper 17834. http://www.nber.org/papers/w17834.

[98] U.S. Department of Education. 1998. *HEA Reauthorization Issue: Using "Prior-Prior" Year Income.* Reauthorization explanatory document.

[99] The College Board. 2012. *Simplifying Student Aid: What It Would Mean for States.* http://advocacy.collegeboard.org/sites/default/files/12b_5073_State_Simplicication_Report_FINAL.pdf.

Streamline the verification process to increase the odds that qualified students receive the aid they applied for.

After the Department receives students' FAFSAs, the agency flags some applications for colleges to "verify." This process requires students to resubmit and document some or all of the information they put on their FAFSAs, which can be onerous for some students. Nearly all aid applicants selected for FAFSA verification are eligible for Pell Grants, making the application process most laborious for those who most need aid. Our research found that the verification process itself reduces the odds that eligible students will actually receive needed Pell Grants. We also found that colleges' verification policies and processes vary considerably and can be unnecessarily burdensome for both students and schools.[100]

More widespread use of the IRS Data Retrieval tool will reduce the need for verification. Still, some amount of verification will remain necessary to prevent fraud and maintain the integrity of the student aid programs. We recommend streamlining federal verification requirements and guidance to focus on areas of known or likely errors. This is in contrast to the current approach, in which the Department can effectively require colleges to verify any FAFSA element for any reason or none at all. For example, applicants who indicate that someone in their family received SNAP (food stamp) benefits in the past two years are currently being required to provide documentation, although Department officials have confirmed that there is no data to indicate common errors on this part of the FAFSA.[101]

Better target available aid and prevent fraud.

Both the application process and the underlying formula affect how students qualify for aid. The formula is set by Congress and includes many financial and nonfinancial elements. Congress frequently and substantially changes the needs analysis formula, at times expanding, refining, or reducing eligibility with rationales that do not necessarily take the likely impact on access or success into account. Recent years have seen reform proposals that run the gamut, from increased complexity by treating untaxed means-tested benefits (such as food stamps) as income, to dramatic simplification by eliminating the FAFSA and basing aid eligibility solely on adjusted gross income (AGI) or AGI plus family size.

While the current system has many flaws that must be addressed, it also has some important aspects that are worth preserving and strengthening in the interest of access and success. For example, financially needier students get larger grants, and grants are prorated for part-time students, avoiding steep and inequitable "cliffs" that leave students in very similar financial situations with very different levels of aid. Students and parents who do not have to file a 1040 have other ways to qualify – and could do so even more easily if W-2 data could be imported into the IRS Data Retrieval Tool as recommended above. It is also important that the formula recognizes that nominally non-financial factors such as dependency status, family size, the number of children in college, and parental age (for dependent students) play a role in how

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[100] For more information, see TICAS. 2010. *After the FAFSA: How Red Tape Can Prevent Eligible Students from Receiving Financial Aid*. http://ticas.org/files/pub/AfterFAFSA.pdf.

[101] Comments of U.S. Department of Education official at the December 2011 Federal Student Aid (FSA) conference.

much someone can actually afford to pay for college. The following recommendations aim to build on such strengths.

Increase the share of questions that can be answered automatically with IRS data.

The more that data elements required for needs analysis match information the government already has, the easier it is to streamline the aid process, from providing early estimates to completing the form to preventing fraud and reducing errors and paperwork. As discussed above, this involves not only the definitions of things like income and family size, but also the year of data required and which federal sources it can be drawn from.

Research has found that AGI plus taxes paid, state of residence, family size, marital status, type of federal tax form used, and number of family members in college explains virtually all (95%) of the variation in Pell Grants. Most of this information is already collected through federal income tax forms. The exceptions are family size, which is defined differently on the 1040, and number of children in college, which families can easily answer. However, the FAFSA also asks questions about assets that are not addressed by the 1040, can be intimidating and time consuming to complete, and have little or no effect on aid determinations for lower income students. For example, question 40 on the 2013-14 FAFSA asks, "As of today, what is your (and spouse's) total current balance of cash, savings and checking accounts? Don't include student financial aid."

We recommend close consideration of ways to better align needs analysis with data available from the IRS while preserving the strengths described above. One example would be to consider defining family size so that it matches the number of IRS exemptions. Another would be to eliminate questions about assets for any applicant with less than $150,000 in relevant assets.

Any changes to needs analysis should ensure that those with the lowest incomes also have a user-friendly way to apply for aid.

Adjust elements of the needs analysis formula to improve aid targeting.

To better target aid to those with more financial need, we recommend several specific changes to the current formula:

- For applicants subject to asset questions, include the value of businesses with 100 or fewer employees in the calculation of the household's net worth. They are currently excluded solely based on the number of employees, regardless of monetary value, which results in poor targeting of aid.

- Protect income required to pay for basic needs, such as housing and food. The needs analysis formula already includes an "income protection allowance" (IPA) for this purpose, but the purchasing power of the amounts of income protected can be very low and vary substantially between types of students.[102] We recommend instead setting this threshold at 150 percent of the appropriate poverty level for the applicant, given their dependency status and family size, so that families are not forced to choose between buying groceries and paying for college. Such a threshold would be consistent with the definition of "discretionary income" used to determine income-based payments for federal student loans, and it automatically adjusts for inflation as well as for family size. It also eliminates the current problem of two aid applicants with earnings that differ by just a few dollars being treated very differently. For context, 150 percent of poverty is $17,235 for a single adult and $35,325 for a family of four in federal fiscal year 2013.[103] This method of setting IPA thresholds better targets aid than the current auto-zero expected family contribution (EFC) threshold, which presumes families below a certain income threshold have zero dollars to spend on college regardless of their family size. It would also make it easier for students to estimate their aid eligibility.

- For students enrolled entirely in online programs, exclude transportation from the cost of attendance estimates that cap how much they can receive in grants and loans. This will help reduce the risk of waste and fraud and limit unnecessary borrowing. Students who take all of their courses online need time to attend class and study just like any other student, and aid can help make up for lost wages while enrolled, but online courses should not have any transportation costs.

Strengthen student accountability measures that support persistence and completion.

As noted in our principles for reform, students, states, and schools share accountability for student outcomes. We believe that federal aid should hold students accountable for studying hard and making continued progress toward their educational goals, just as it should hold states and schools accountable for the conditions that make such progress possible and affordable. To better target aid and promote both access and success, we propose the following improvements to federal rules:

- Students should not be better off if they drop out than if they drop classes but stay enrolled. Currently, students who start full time and have to drop all of their courses in the middle of the term are unlikely to have to give back any of their aid (Return to Title IV, or R2T4). That is because a portion of grant funds students receive is rightly protected from needing to be returned in the case of withdrawal, a provision which recognizes that students may have spent those funds on books, food, or other costs that cannot be recouped. In contrast, students who start full time and drop *most* of their courses – but not all – may owe money, and they cannot receive additional federal aid until it has been repaid (an overpayment). If students demonstrate a *pattern* of either dropping out or dropping courses, they will become ineligible for aid under rules

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[102] For instance, scheduled IPA levels for 2013-14 range from 63 percent to 162 percent of poverty, depending on the student's dependency status, family size, and number of family members in college. For more information, see http://ticas.org/files/pub/IPA_Rollback_in_House_FY13_Budget_06-18-12.pdf.

[103] Calculations by TICAS using data from the U.S. Department of Health and Human Services. "2013 Poverty Guidelines." http://aspe.hhs.gov/poverty/13poverty.cfm.

requiring satisfactory academic progress (SAP). Federal aid policy should always encourage students to stay in school rather than drop out, and squeezing them out over funds used for tuition, books, or other costs that cannot be recouped is at odds with a goal of student success.

- A September 2011 report of the Office of Inspector General (OIG) described the anatomy of distance education fraud rings, and it recommended a number of steps the Department should take to mitigate the risk of fraudulent activity.[104] Most of the ways identified by the OIG report to pinpoint potential fraud – such as identifying common street addresses, IP addresses, or web server logs – can and should be implemented administratively by the Department, which has data on all FAFSA applicants and federal aid recipients nationwide. Focusing these efforts at the federal level maximizes student privacy and minimizes institutional burden. Having robust federal administrative policies and procedures to hunt for fraud and properly identify high-risk applicants will help colleges make more efficient use of their resources. For instance, the Department should immediately start flagging for colleges potential fraud ring participants who repeatedly enroll at and withdraw from school after school.

- Consider students' total enrollment history in determining aid eligibility in certain circumstances. Existing SAP standards are designed to ensure that students make ongoing progress towards an appropriate academic or vocational goal while receiving aid. They were recently strengthened to standardize terms and statuses across colleges and ensure college policies are not looser than federal law allows. We affirm the importance of these standards and propose requiring colleges to consider students' total enrollment history in determining academic progress when fraud is suspected. For students flagged by the Department (see above) as having an application and/or aid history suggestive of fraud, colleges should collect information about prior enrollment history and include courses attempted at other colleges in SAP calculations. Colleges would have the authority to ignore prior coursework in certain circumstances, using professional judgment if a student's questionable application and/or aid history has a reasonable explanation. Students would retain the ability to appeal if their situation has changed in ways that make their future academic potential more promising than their prior academic history.

[104] U.S. Department of Education, Office of Inspector General. 2011. *Investigative Program Advisory Report: Distance Education Fraud Rings*. http://www2.ed.gov/about/offices/list/oig/invtreports/l42l0001.pdf.

Section 3: College Eligibility and Accountability

To ensure that available federal aid dollars are spent wisely, we propose more closely tying colleges' eligibility to the risk to students in enrolling and the risk to taxpayers in investing, with rewards for colleges where risks are low. While students are and should be held accountable for the effort needed to earn a credential, colleges must be held accountable for delivering quality education to their students as a whole. In other words, when one student fails to graduate with a worthwhile degree, or graduates with insurmountable debt, it may be the fault of the student. When many or most students at a college meet the same fate, however, the school should bear some or most of the responsibility.

In summary, our recommendations are to:

- Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR).
- Require risk-sharing for colleges on the margins of Title IV eligibility that receive a majority of revenue from federal aid.
- Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment.
- Provide greater flexibility to innovate to schools with strong track records.
- Improve oversight and other accountability measures to better protect students.

Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR).

The federal government uses "cohort default rates," or CDRs, to assess colleges' eligibility for federal student aid funding from the U.S. Department of Education (Title IV funding). CDRs measure the share of a school's borrowers who default (i.e., make no payment for at least nine months) within the first few years of repayment. Colleges with CDRs above certain thresholds may face sanctions that end their eligibility for federal aid.

While CDRs provide useful information on how likely student loan borrowers from individual colleges are to default within a given timeframe, they are, by themselves, insufficient to inform consumers or policymakers about how *students* – both borrowers and non-borrowers – fare. That is because they exclude non-borrowers. Without knowing how many students borrowed loans in the first place, the share of them who defaulted is less meaningful.

Current law already acknowledges that colleges' borrowing rates are important context for CDRs. Colleges where relatively few students borrow, but that have relatively high CDRs, can appeal a potential loss of aid eligibility based on their "participation rate index" (PRI), a measure that combines colleges' default rates and borrowing rates. The PRI recognizes that CDRs may not be representative indicators of institutional quality at colleges where they reflect the outcomes of a small share of students.

Our proposal furthers this concept of the PRI by applying it to all colleges in the form of a "Student Default Risk Index" (SDRI) that would replace the CDR in assessing a college's eligibility for Title IV funding.[105] The SDRI is the three-year CDR multiplied by the school's borrowing rate. By incorporating the share of students who borrow loans into the measure, the SDRI more accurately conveys a student's risk of default at a given school.

For example, consider two schools with CDRs of 20 percent. At the first school, 90 percent of students borrow, so roughly 18 out of every 100 enrolled students end up in default on student loans shortly after entering repayment. At the second school, only five percent of students borrow, so only one out of 100 students end up in default within the same time period. The CDRs are the same, but the extent of the schools' default problems is quite different. The SDRI captures the risk to students and the extent of a school's default problem in one number, rather than requiring an examination of both the school's borrowing rate and default rate to assess the risk.

The SDRI Calculation

	CDR	Borrowing Rate	Students' Risk of Default	SDRI
College 1	20%	90%	18%	18
College 2	20%	5%	1%	1

Similar to the current CDRs, schools with SDRIs above a specified threshold would no longer be eligible for Title IV aid.[106] The appropriate cutoff threshold needs careful consideration. For reference, the California legislature has twice considered using the SDRI for the purpose of determining institutional eligibility for state Cal Grants. In 2011, the proposed cutoff was 7.5 in any single year, using two-year CDRs.[107] In 2012, the proposed cutoff was 15.0 in any single year, using three-year CDRs.[108]

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[105] Other criteria for eligibility, including the 90-10 rule, would remain intact but modified as described in this section.

[106] Importantly, this would eliminate the need for colleges with low borrowing rates to appeal losses of eligibility using the PRI, as their borrowing rate would already be taken into account.

[107] Asimov, Nanette. March 9, 2011. *San Francisco Chronicle.* "DeVry, Heald Among Those Facing Cal Grant Cuts." http://www.sfgate.com/default/article/DeVry-Heald-among-those-facing-Cal-Grant-cuts-2389489.php.

[108] California Assembly Bill No. 1637 (2011-12 reg. session). http://bit.ly/VX2yfY.

How SDRIs Would Work

Currently, colleges generally lose all eligibility for Title IV aid if, over three consecutive years, 30 percent of their borrowers default on their student loans (CDR = 30%) within the first three years of repayment. Because they account for the share of students borrowing at a college, which cannot exceed 100 percent, SDRI scores are virtually always more lenient than CDRs of the same number. To illustrate, an SDRI cutoff of 30 is only equal to a CDR of 30 percent at schools where *every* undergraduate student borrows (30 times 100% equals 30), and at a college where 90 percent of students borrow, an SDRI cutoff of 30 would be equivalent to a CDR cutoff of 33.3 percent.

Determining the appropriate SDRI cutoffs for these categories will require careful consideration. However, to strengthen institutional accountability for colleges, the SDRI eligibility cutoff must be lower than 30. For discussion, we have provided some comparisons below.

Comparison of CDR and SDRI Thresholds

	Current CDR Thresholds: ≥ 30% CDR for three consecutive years, or >40% for any single year	Sample SDRI Threshold: SDRI ≥ 25
College A **CDR = 43%** **Borrowing rate = 49%**	Above thresholds, may lose eligibility	SDRI = 21, will not lose eligibility
College B **CDR = 29%** **Borrowing rate = 92%**	Below thresholds, will not lose eligibility	SDRI = 27, may lose eligibility

Student Defaults and Student Demographics

Some have suggested that colleges should not all be held to the same default standards, arguing that colleges that enroll more low-income students should be held to weaker standards than those who enroll high-income students. While student demographics play a role, the evidence is clear that demographics are by no means the sole explanation for default rates. Schools play an important role, and we should neither have lower standards for some students nor expect the least from schools that receive the most subsidy. Low-income and minority students should not be left to expect fewer jobs, lower salaries, and higher debts.

- A study commissioned by the main for-profit college trade association found that even after accounting for differences in student demographics, students attending for-profit colleges are at least twice as likely to default as students at other types of colleges.*

- Lenders report that the school attended affects a student's chance of default. In its private student loan business, Sallie Mae expects to see a 30 percent difference in default rates for a borrower with a FICO score greater than 700, "depending on the school that borrower attends."**

- A 2010 Education Sector report also documents the role schools can play in lowering default rates: "[T]he experience of the Texas HBCUs, along with a new statistical analysis of cohort default rates, suggests that dangerously high default rates for institutions that serve at-risk students are not inevitable.... Their [the Texas HBCUs'] success is not only applicable to other similar institutions, but to all schools that serve those students most at risk for default and who are committed to helping them."***

[*] Charles River Associates for the Career College Association. 2010. *Report on Gainful Employment.* http://1.usa.gov/hleokn.

[**] *Student Lending Analytics Blog*. February 12, 2010. "Highlights of Sallie Mae Investor Meeting at Credit Suisse Conference." http://bit.ly/TiEANk.

[***] Education Sector. 2010. *Lowering Student Loan Default Rates: What One Consortium of Historically Black Institutions Did to Succeed.* http://www.educationsector.org/usr_doc/Default_Rates_HBCU.pdf.

Require risk-sharing for colleges on the margins of Title IV eligibility that receive a majority of revenue from federal aid.

To further increase institutional accountability, as well as protect and target taxpayer investment, we also propose requiring that some colleges share students' and taxpayers' financial risk. Our proposal would apply to colleges that receive more than half of their annual revenue from federal aid (including Title IV as well as U.S. Department of Defense and Veterans Affairs benefits) and have SDRIs that are relatively high but fall below the eligibility cutoff. Currently, eligibility for federal aid is all or nothing, with no form of risk-sharing in place.

Affected colleges would be required to pay a risk-sharing fee equal to a percentage of either their annual loan volume or total amount of federal student aid received that year. The fees would go into an account managed and operated by the U.S. Department of Education (the Department) and used to fund the following: loan discharges because of school closures, false certification, or other fraud; improvements in loan counseling; loan default reduction efforts; and/or Pell Grants. Similar to insurance programs, higher risk colleges with high loan volumes and high SDRIs would pay more into the pool, with the percentages of loan volume paid increasing as colleges' SDRI increases. Also similar to insurance programs, the money a school pays into the account would not be restricted to assisting students from that school.

For instance, using example thresholds provided on page 38 (provided for illustration purposes only), and assuming fees of up to 10 percent of the total loan volume at affected colleges, we estimate that this proposal would generate at least $440 million in a single year for the purposes described above. Increasing the maximum percentage fee to 20 percent would generate double that amount, or at least $880 million.[109]

This concept of risk-sharing and graduated institutional eligibility could also be implemented using student loan repayment rates or other measures of risk. If some schools continue to be permitted to manipulate and artificially lower their CDRs, as discussed below, then alternative measures of students' ability to repay their loans should be considered. Additionally, the SDRI and/or repayment rate thresholds would need to be adjusted if enrollment in income-based repayment plans increases significantly, because that would lower the number of students

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[109] Calculations by TICAS using data from the U.S. Department of Education: FY09 three-year CDRs, 2010-11 undergraduate borrowing rates, 2010-11 Stafford Loan volume, and 2010-11 proprietary school 90-10 revenue percentages. Colleges with no students entering repayment in the FY09 cohort, those that did not disburse Stafford Loans in 2010-11, and those with no undergraduates enrolled were excluded from the estimates. Lacking comprehensive data on which public and nonprofit colleges receive more than half of their revenue from Title IV aid, our minimum estimate includes only risk-sharing contributions from for-profit colleges. Under this estimate, colleges' share of loan volume needed for risk-sharing would be equal to the SDRI (rounded down to the nearest integer) minus 14, expressed as a percentage, for colleges with SDRIs of at least 15 but less than 25. For example, the risk-sharing fee would be one percent of loan volume for a college with an SDRI of 15.5 and 10 percent of loan volume for a college with an SDRI of 24.5. At these contribution levels and based on the most recent data available, we estimate that for-profit colleges with SDRIs at or above 15 and below 25 would contribute $455 million. We decreased this figure by three percent to recognize that approximately 3 percent of for-profit Title IV aid goes to colleges at which Title IV revenue comprises less than a majority of funding and would therefore not be subject to required risk-sharing.

entering default and reduce CDRs for reasons unassociated with the colleges. Steps would also need to be taken to prevent schools from discouraging students from borrowing for the sole purpose of lowering the school's SDRI rather than it being in the student's best interest.

Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment.

We also propose using the SDRI to allocate additional grant aid to colleges that keep students' likelihood of default very low. Under this proposal, colleges with SDRIs below a designated threshold would receive a certain amount of funding based on the amount of Pell Grant dollars disbursed to their students. By basing the additional funding on Pell Grant dollars disbursed, colleges would be encouraged to enroll low-income students, help them apply for aid, and support them in enrolling full time. Colleges would have flexibility in how they award the additional funds, similar to current campus-based aid programs through which colleges receive federal funds to disburse as they deem appropriate to meet their students' financial need. Should the enhanced Pell Grant described in Section 4 be fully funded, colleges would not be required to spend these funds on student financial aid but would have the flexibility to use these funds however they see fit, including on student services or financial aid administration.

Only colleges offering federal loans would be eligible for this supplemental funding. More than one million community college students nationally are enrolled at colleges that have chosen to restrict their students' access to federal aid by not offering federal student loans.[110] This additional funding would serve as an incentive for colleges to offer federal loans, and colleges' continued choice not to offer loans would be understood as a statement that neither the college nor its students need additional funding.

Based on SDRIs using three-year CDRs for fiscal year 2009, roughly $1 billion in supplemental grant funds would provide colleges with SDRIs below two with roughly $750 per maximum Pell Grant award. Rewarding colleges with SDRIs below five at the same rate would cost roughly $2.2 billion.[111] This new program could be created in addition to or instead of the Federal Supplemental Educational Opportunity Grant (SEOG), through which about $1 billion per year is awarded.[112] Our proposal would help shift campus-based aid resources to colleges that enroll low-income students and serve them well, a shift in direction that should occur for all federal campus-based aid.[113] Currently, campus-based aid resources are more heavily concentrated at

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[110] TICAS. 2011. *Still Denied: How Community Colleges Shortchange Students by Not Offering Federal Loans.* http://projectonstudentdebt.org/files/pub/still_denied.pdf.

[111] Calculations by TICAS using data from the U.S. Department of Education: FY09 three-year CDRs, 2010-11 undergraduate borrowing rates, and 2010-11 Pell Grant volume. Colleges with no students entering repayment in the FY09 cohort and those that did not disburse Stafford Loans in 2010-11 were excluded from the estimates. For each college with an SDRI below two, we divided their total Pell disbursements by the size of the maximum 2010-11 Pell Grant ($5,550) and then multiplied by $750, for a total of $920 million.

[112] For more information about SEOG, see http://www2.ed.gov/programs/fseog/index.html.

[113] For more information about reallocating campus-based aid, see http://www.ticas.org/files/pub/POTUS_Proposal_Jan_2012_STA.pdf.

schools based on unrelated factors, such as the length of time that the school has been in the program.

Provide greater flexibility to innovate to schools with strong track records.

In addition to holding poorly performing schools more accountable, federal policies should provide greater flexibility and incentives for innovation to colleges with a record of graduating low- and moderate-income students with meaningful credentials and without burdensome debt. While a school's own policies, practices, and internal systems may be a greater obstacle to innovation, there is no question that federal student aid policies can be a barrier to finding new ways to provide greater access to a quality education at a lower cost.

With few exceptions, federal policies currently treat all colleges alike, regardless of their record of serving students well. This means the policies in place to protect taxpayers and students attending relatively new for-profit colleges such as the Sawyer School or American Career Institute, whose sudden closing of campuses left thousands of students displaced and stranded, usually also apply to public colleges like the University of California at Riverside or SUNY Stony Brook, which have been around for more than 50 years and without disruption successfully graduate low-income and minority students with manageable debt.[114] There is precedent for providing greater flexibility to colleges based on their track records. For example, under current law, schools with lower default rates are given greater flexibility in the disbursement of student loans.[115] In addition, nonprofit and for-profit colleges with strong "financial responsibility scores" are subject to less oversight and monitoring than schools with lower financial responsibility scores.[116] However, these examples are exceptions to the general rule of a one-size-fits-all approach to regulation and oversight, which tends to overregulate the best colleges and underregulate the worst.

To foster innovation and target the strongest oversight where it is most needed, more policies should take into account how well a college serves students in terms of access, affordability, and success (completion with a quality degree without burdensome debt). This is why TICAS and three student organizations urged the Department to review only new career education programs offered by institutions with poor track records (as measured by their program repayment rates and debt-to-income ratios), instead of scrutinizing such programs at all

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[114] Di Meglio, Francesca. January 9, 2013. "Investigators Probe Shuttered For-Profit Colleges." *Bloomberg Businessweek*. http://www.businessweek.com/articles/2013-01-09/investigators-probe-shuttered-for-profit-colleges#r=hpt-fs. Halperin, David. January 14, 2013. "For-Profit College Shuts Down, Leaving Students Out in the Cold." *Huffington Post Blog*. http://www.huffingtonpost.com/davidhalperin/for-profit-college-shuts_b_2474087.html.

[115] For example, schools with a CDR of less than five percent are eligible to make single and nondelayed disbursements of loans for attendance in a study-abroad program. Schools with default rates of less than 15 percent are not required to delay the delivery or disbursement of loans for 30 days for first-time, first-year undergraduate borrowers. For more information, see http://ifap.ed.gov/DefaultManagement/finalcdrg.html.

[116] For more information on the relationship of financial responsibility scores to levels of oversight, see http://studentaid.ed.gov/about/data-center/school/composite-scores.

institutions.[117] Limiting new program reviews to institutions with poor records provides a strong incentive for institutions to ensure their programs are of high quality, and also reduces the administrative burden for institutions that have already demonstrated a strong record of preparing students for gainful employment.

Example of SDRI Thresholds for School Sanctions, Risk-Sharing, and Rewards

SDRI	Treatment
≥ 25	Ineligible for federal aid
< 25 and ≥ 15	Risk-sharing rules apply to colleges receiving a majority of their revenue from federal taxpayers
<2	Eligible for additional federal funding per Pell Grant dollars disbursed and/or greater flexibility to innovate

It is important to note that any student outcome measure used to assess an institution must be carefully chosen to avoid unintended consequences, such as rewarding schools for graduating students from costly but worthless short-term certificate programs or for only enrolling the lowest risk students. However, this should not deter policymakers from looking for opportunities to design policies that effectively reward institutions for positive outcomes in addition to holding them accountable for troubling ones.

Improve oversight and other accountability measures to better protect students.

Current institutional eligibility rules are much too weak. Whether the current CDR measure and standards continue to be used to sanction schools or are replaced with the more robust SDRI, there are a number of additional policy changes that must be made to ensure the integrity of the federal student aid programs.

- **Investigate schools that manipulate their CDRs in an attempt to avoid oversight.** The Department must do more to ensure that colleges do not evade sanctions through CDR manipulation. Whether used as a standalone measure or as part of an SDRI calculation, the measure of student loan default must be meaningful. As written in law, the measurement includes only borrowers who fail to make any payment for an entire year in a two- to three-year period. In general, colleges do not fully lose eligibility for

[117] September 9, 2010 comments submitted by TICAS and three national student groups (the United States Students Association, U.S. Public Interest Research Groups, and Campus Progress) on proposed regulations to define gainful employment at http://ticas.org/pub_view.php?idx=661. More than 20 student, consumer, education, and civil-rights organizations endorsed a similar approach in November 14, 2011 comments on proposed rules regarding new gainful employment programs at http://ticas.org/files/pub/GE_New_program_approval_commentsFINAL_Nov14.pdf.

aid until they have CDRs at or above 30 percent for three consecutive years or above 40 percent for one year. This is a very weak standard, which has been further weakened by college practices that manipulate their default rates. For example, a number of colleges have admitted to masking serious problems by having would-be defaulters burn through time-limited repayment protections (e.g., forbearance), or by consolidating campuses to mask very high default rates at certain locations. The Department could address these issues by investigating instances of repeat forbearances and monitoring colleges' CDRs as both consolidated and separate entities for a specified period of time.[118]

- **Make the process of administering CDR sanction appeals automatic for colleges with low borrowing rates.**
  Currently, many colleges with low borrowing rates that could benefit from the PRI appeal (described above) do not know about it, understand how it works, or know how to apply for it.[119] If sanctions based on CDRs are not replaced by sanctions based on SDRIs, the Department should administer these appeals automatically with minimal new data collection. The Department should also be providing this type of guidance proactively.

- **Tell schools what is permissible under a policy, not just what is impermissible.**
  It can be challenging to explain what colleges may do as well as what they may not do, but it is essential for the Department to be more detailed to prevent colleges from incorrectly believing they do not have authority to innovate. Even without changes in federal policy, the Department could promote innovation simply by better informing colleges about what they may do under current regulations. For instance, some colleges have expressed concern that current policies do not permit them to deny students access to federal loans even when the school believes it is not in the student's best interest to borrow more. TICAS, in collaboration with the California Community College Student Financial Aid Administrators Association (CCCSFAAA), recently issued a report (*Making Loans Work: How Community Colleges Support Responsible Student Borrowing)* documenting how colleges can and do counsel students on borrowing, including denying students loans on a case-by-case basis when warranted.[120]

- **Strengthen the federal "90-10" rule.**
  The "90-10" rule prohibits for-profit colleges from receiving more than 90 percent of their revenue from federal student aid. Since being enacted with strong bipartisan support in 1992, the rule has been weakened substantially and includes loopholes that allow colleges to count GI Bill funds and U.S. Department of Defense Tuition Assistance as private rather than federal dollars. Bills have been introduced in both the Senate and

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[118] For more information on ways for-profit college companies may be manipulating their CDRs and steps the Department should immediately take to ensure full compliance with federal law and protect taxpayers from subsidizing schools with CDRs above the permitted thresholds, see TICAS' August 2012 memo at http://ticas.org/pub_view.php?idx=856.

[119] For more information about why the current appeals process is problematic, see TICAS. 2011. *Still Denied: How Community Colleges Shortchange Students by Not Offering Federal Loans*. http://projectonstudentdebt.org/files/pub/still_denied.pdf.

[120] CCCSFAAA and TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing.* http://ticas.org/files/pub/Making_Loans_Work.pdf.

House to close this loophole and strengthen the 90-10 rule to remove the existing incentive to exploit veterans, service members, and their families.[121]

- **Strengthen and enforce the "gainful employment" rule.**
  Federal law has long required career education programs at all types of colleges to prepare students for gainful employment, but the lack of a definition of "gainful employment" has prevented the law from being enforced. The Department's recent efforts to define the term and enforce the law are currently tied up in the courts, but the Federal District Court both affirmed the Department's authority to enforce the law and the need to do so.[122] Swift action must be taken to ensure that both students and taxpayers are protected from unscrupulous schools that seek to swindle them and routinely saddle students with debts they cannot repay.[123] Schools also need to be held accountable for providing the disclosures required for gainful employment programs so that students can make informed decisions about where to attend.

- **Bar schools from using federal student aid dollars for advertising, marketing, and recruiting.**
  A two-year investigation by the Senate Health, Education, Labor, and Pensions (HELP) Committee revealed that the majority of students at 30 for-profit college companies left without a degree but almost all their students had debt. The 30 for-profit college companies examined spent on average more than twice as much on marketing, recruiting, and profits (42%) as on instruction (17%).[124] In Fiscal Year 2009, these companies spent $4.2 billion, or 23 percent of their budgets, on advertising, marketing, and recruitment. Senate and House legislation to prohibit any type of college from using federal taxpayer dollars for advertising and recruiting has been endorsed by a diverse range of organizations representing veterans and advocates for students, consumers, civil rights, and education.[125]

- **Impose intermediate sanctions when appropriate to protect students and taxpayers.**
  Even when accreditors or the Department find serious problems at a college, they rarely revoke the school's accreditation or eligibility for federal student aid because it can be tantamount to closing the school. In the meantime, students continue to enroll unaware of the problems and taxpayers continue to subsidize their enrollment. Even when the problems are so severe that the schools are required to notify their board and/or investors of the problem, students are often left in the dark. As the Association of Public and Land-grant Universities recently recommended, the Department should, when

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[121] For more information about the 90-10 Rule, why it needs to be strengthened, and the veterans' and military service groups and leaders that support a stronger 90-10 Rule, see http://bit.ly/WDpimn.

[122] For more information, see http://views.ticas.org/?p=884.

[123] For more information about the broad coalition in support of greater accountability for career education programs, see http://www.protectstudentsandtaxpayers.org/.

[124] Senate HELP Committee. 2012. *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*. http://www.help.senate.gov/imo/media/for_profit_report/Contents.pdf.

[125] For more information about the Protecting Financial Aid for Students and Taxpayers Act, see http://www.hagan.senate.gov/?p=press_release&id=1770 and http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.340:.

appropriate, exercise its authority to impose intermediate sanctions on schools, such as limiting their eligibility for Title IV funding and requiring that students are notified of the problems.[126] The sanctions could be lifted once the school addresses the problem.

Greater use of intermediate sanctions would both better protect students and taxpayers and better deter problems in the first place.

Section 4: Grant Aid

The federal Pell Grant program is the largest single source of need-based grant aid in the country. It helps more than nine million college students nationally cover college costs.[127] These students of all ages are enrolled in undergraduate programs ranging from short-term certificates to bachelor's degrees.

The Pell Grant has evolved over time, with statutory changes that have expanded or contracted eligibility, with a range of rationales. The basic premise, however, has remained the same: to help ensure access to college for students with the willingness and dedication to earn a college credential but with scarce financial resources.

Through the recent economic downturn, the Pell Grant program has responded as a counter-cyclical program should: by expanding in times of greater need to help more people to and through college. When more people had less income and all the reason to seek postsecondary education, the Pell Grant program was able to respond immediately to provide critical support. Thus, while the increased costs have attracted scrutiny, they are neither surprising nor undesirable. Creating a better-educated workforce is the surest path to a strong economy. The Pell Grant program helps to ensure that our lowest income students have the opportunity to be part of that workforce, which is crucial to the nation's future as well as their own.

Unfortunately, low-income students are still less likely to go to college than their equally prepared, higher income peers. Those who do attend college are less likely to persist or graduate. These achievement gaps by income have widened over recent decades, not narrowed. As researchers Bailey and Dynarski found, "Even among those who had the same measured

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[126] Association of Public and Land-grant Universities. 2013. *Federal Student Aid: Access and Completion.* http://www.aplu.org/page.aspx?pid=2616. P. 7.

[127] For other key facts about the Pell Grant program, see http://ticas.org/files/pub//Overall_Pell_one-pager_11-26-12.pdf.

cognitive skills as teenagers, inequality in college entry and completion across income groups is greater today than it was two decades ago."[128]

Over this same period, college costs have grown much faster than families' ability to pay, and grant aid has not kept pace. Today's maximum Pell Grant ($5,550 in 2012-13) covers the lowest share of college costs since the start of the program, covering only 31 percent of college costs compared to more than twice that in the late 1970s (between 69% and 84%).[129] Despite a small increase for 2013-14, next year's maximum grant of $5,635 will cover only 30 percent of costs.

To increase the effectiveness of the federal Pell Grant, we make the following recommendations:

- Double the maximum Pell Grant to close income gaps in access and attainment.
- Consider maintenance of effort provisions to discourage disinvestment.
- Make Pell Grants a mandatory program.
- Better align Pell Grant program parameters and policies with goals.

Double the maximum Pell Grant to close income gaps in access and attainment.

We propose setting the maximum Pell Grant at an amount designed to overcome income gaps in college access and success. Specifically, evidence suggests that the Pell Grant needs to be roughly doubled.

Exactly how to determine the appropriate maximum Pell Grant award will require careful consideration and analysis of available literature. While the presence of income gaps has been well documented, many studies do not take other critical factors, like academic preparation or college selectivity, into account. Similarly, many researchers have found links between grant aid and students' likelihood of enrollment, persistence, and completion, but much of it is focused beyond the Pell Grant program or even need-based grant aid specifically.

Still, the evidence that does exist shows the same general trends: that low-income students are much less likely to enroll or complete than higher income students, and that increased, targeted grant aid increases their chances of enrolling and completing. Providing sufficient grant aid can help to close gaps in college enrollment and completion. Here are examples of how the size of a sufficient grant might be determined (see footnotes for study citations):[130]

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[128] Bailey, Martha and Susan Dynarski. 2011. *Gains and Gaps: Changing Inequality in U.S. College Entry and Completion.* National Bureau of Economic Research. Working Paper 17633, http://www.nber.org/papers/w17633.pdf. P. 12.

[129] College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012*, Table 2, http://bit.ly/14OJvbv, and U.S. Department of Education data on the maximum Pell Grant.

[130] By using available research to quantify both income gaps and financial aid effects, we can estimate how much financial aid it would take to close the gaps. For instance, in the first row, if $1,000 of financial aid increases the probability of enrollment by

Evidence of Gap to Close	Evidence of Financial Aid Effect	Resulting Maximum Pell for 2013-14
Enrollment in postsecondary education by age 18-22: 30% poverty, 59% non-poverty, **29 percentage point gap.**[131]	A $1,000 increase in grant aid increased the probability of enrollment by **4.0 percentage points.**[132]	$12,200
Four-year college enrollment of high school graduates who completed at least trigonometry: 73% low-income, 90% high-income, **17 percentage point gap.**[133]	$1,000 in need-based state grant aid increased the likelihood of immediate enrollment in a public four-year college by **2.5 percentage points.**[134]	$10,800
B.A. attainment of students who completed at least trigonometry in high school and started at a four-year college: 69% low-income, 88% high-income, **19 percentage point gap.**[135]	$1,000 in need-based state grant aid increased the likelihood of earning a B.A. within six years by **3.5 percentage points.**[136]	$9,400
Among students whose highest high school math is Algebra 2, completion rates at moderately selective four-year colleges: 52% lowest income quartile, 73% highest income quartile, **21 percentage point gap.**[137]	$1,000 in need-based state grant aid increased the likelihood of earning a B.A. within six years by **3.5 percentage points.**[138]	$11,200

4.0 percentage points, then it would take $7,250 in additional aid to close a 29 percentage point gap. We then inflate the value of the maximum Pell Grant available in the base year of the research documenting the enrollment/completion gap (in this example, a maximum grant of $3,750 in 2001-02), and add the Pell supplement needed to close the gap. We add the supplemental funding in current dollars (as opposed to the base year grant) to derive solid yet conservative estimates and to reflect the consistent finding that $1,000 of additional grant aid, in a variety of years, has demonstrable effects.

131 Pathways to Postsecondary Success. 2012. *Low-Income Young Adults Continue to Face Barriers to College Entry and Degree Completion.* http://pathways.gseis.ucla.edu/publications/201201_ashtianifelicianoRB_online.pdf.

132 Dynarski, Susan. 1999. *Does Aid Matter? Measuring the Effects of Student Aid on College Attendance and Completion.* National Bureau of Economic Research. Working Paper 7422. http://www.nber.org/papers/w7422.

133 Advisory Committee on Student Financial Assistance (ACSFA). 2006. *Mortgaging Our Future: How Financial Barriers to College Undercut America's Global Competitiveness.* http://www2.ed.gov/about/bdscomm/list/acsfa/mof.pdf.

134 Castleman, Benjamin and Bridget Terry Long. 2012. *Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence, and Graduation.* http://bit.ly/Y0FUCW.

135 ACSFA 2006.

136 Castleman and Long 2012.

137 TICAS calculations based on data from the U.S. Department of Education, 2003-04 Beginning Postsecondary Students Longitudinal Study, Second Follow-Up (BPS:04/09).

138 Castleman and Long 2012.

These imprecise estimates range from $9,400 to $12,200 and each would represent a significant increase in the maximum Pell Grant, to roughly double on average the scheduled 2013-14 maximum grant of $5,635. However, it is worth noting that even a doubled maximum Pell Grant of $11,270 would cover a smaller share of college costs (60%) than the maximum grant covered in the late 1970s.[139]

Once an appropriate maximum Pell Grant amount is determined, it should be indexed to increase over time and could be phased in over a period of several years to manage the upfront cost. For students whose Pell eligibility exceeds their total college costs, their Pell Grant would be capped at their cost of attendance. To retain the highly targeted nature of Pell Grants, larger maximum awards could be provided by giving additional funding to students who meet current Pell eligibility criteria. This would have the effect of providing larger grants to Pell recipients without greatly increasing the number of students who are eligible. This is in contrast to the current formula, through which increases in the maximum award automatically broaden the range of students eligible for grants.

Our proposal to significantly increase Pell Grants to restore their purchasing power and better target funds to the students who need them most will require billions of dollars more. This investment is sound and supported by the evidence. It is also necessary if we are serious about making college affordable for all students willing to study hard, so that we can maintain and build an internationally competitive workforce. See Appendix for more details on ways to cover this cost.

Consider maintenance of effort provisions to discourage disinvestment.

States and institutions have a critical role to play in supporting student access and success. Unfortunately, as discussed in Section 1, states have been retreating from their commitment to higher education support. Therefore, with the significant increase in federal investment that we recommend, Congress should consider "maintenance of effort" (MOE) provisions to ensure that new federal dollars are leveraged efficiently and do not displace state and institutional dollars. Additionally, Congress should consider language to ensure that as new Pell Grant funding is ratcheted up over time, that those dollars supplement, not supplant, state- and institution-based aid.

Make Pell Grants a mandatory program.

The Pell Grant is unique among all federal programs. It functions like an entitlement, but is largely funded as a "discretionary" program, subject to annual appropriations by Congress.[140] In

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139 College costs defined here as average total tuition, fees, room, and board costs at public four-year colleges. Calculations by TICAS on data from the College Board, *Trends in College Pricing 2012*, Table 2, and U.S. Department of Education data on the maximum Pell Grant.

140 For more on how Pell Grants are funded, see http://febp.newamerica.net/background-analysis/federal-pell-grant-budget-scoring-rule.

years when the appropriations provided are insufficient to cover actual program costs, funding gaps are created, and when appropriations exceed actual costs, surpluses are created. Periodic funding gaps and surpluses are inevitable given how it is currently funded. For example, after several years of funding gaps, during which the program was cut in multiple ways, the program is now projected to have a $9.2 billion surplus in fiscal year 2013 and a $4.5 billion surplus in fiscal year 2014.[141] As long as its funding is subject to annual appropriations, no amount of cutting or increased funding can prevent Pell Grant funding gaps and assure it sufficient annual funding. To best enable access and success, Pell Grants need to be funded as a mandatory program, not subject to annual appropriations.

Because Pell Grants operate like a mandatory program, every qualified student receives a Pell Grant, regardless of how many other students are eligible in a given year. The mandatory aspect of the program is what makes it possible to guarantee every qualified student a Pell Grant and for Pell Grants to be available when sudden changes in the local or national economy lead to an influx of students seeking more education and training. When the economy sank in 2008 and millions of Americans lost their jobs, the Pell Grant program responded immediately, with its funding peaking in 2011. For the same reasons, both farm subsidies and the school lunch program are mandatory programs, enabling them to respond immediately to the needs of farmers and children without having to wait for elected officials in Washington, D.C. to act.

However, despite operating like a mandatory program, Pell Grants are still largely funded as a discretionary program. As a result, Pell Grants and students are subject to annual budget appropriations and negotiations, with policy discussions centered around what costs the most, rather than what matters the most. A glaring example of this is when Pell Grants recently had a funding gap, Congress chose to cut grants for more than 100,000 recipients – transfer students and those near graduation in particular – by implementing a retroactive, six-year time limit on Pell receipt. (See Section 1 for more information on this policy change.)

Low-income students and their college plans must not hang in the balance from year to year. Such uncertainty undermines both access and success for students with no financial cushion to fall back on if their grants unpredictably shrink or disappear. Making all Pell Grant funding mandatory would match the purpose and countercyclical nature of the program.

Transitioning the Pell Grant program from a discretionary program to a mandatory one can be difficult under budgeting rules, but the Budget Control Act passed in 2011 provides an avenue for this transition to occur more easily. Pell Grant spending falls under a discretionary spending cap, and the cap could be reduced by the size of the Pell Grant program – creating savings – to allow it to be recreated as a mandatory program.

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141 Assumes Congress maintains the FY12 discretionary appropriation for Pell Grants in FY13 and FY14. Calculations by the Center on Budget and Policy Priorities on data from the Congressional Budget Office (CBO), February 2013 baseline projections for the Pell Grant program, http://cbo.gov/sites/default/files/cbofiles/attachments/43912_PellGrants.pdf.

Better align Pell Grant program parameters and policies with goals.

- **Rename Pell Grants as Pell Scholarships.**
  This would better convey the academic expectation of all recipients. Focusing on the positive factors associated with Pell Grants (achievement) rather than the negative ones (poverty, need) may increase the meaning of and response to the awards.[142] No additional merit criteria for grant eligibility should be introduced pursuant to this change.

- **Limit to two the number of semesters that a student can be enrolled less than half time and receive a Pell Grant.**
  Studies have shown that less-than-half-time students are similar in many ways to students enrolled in more units, and students who enroll less than half time typically do so only rarely and in response to special circumstances.[143] Allowing limited Pell Grants for less-than-half-time attendance would encourage students to take more courses but provide a reasonable allowance for unforeseen circumstances that limit course-taking ability.

- **Set the lifetime limit for Pell at an amount designed to allow completion of a bachelor's degree.**
  The recent creation of a retroactive six-year time limit for Pell Grants was not only devastating for students (see Section 1 for more information on this policy change), but it was also inconsistent with other federal rules. Satisfactory academic progress (SAP) guidelines allow for aid eligibility up to 150 percent of the program length, and with full-time awards available with a 12-credit courseload, this would mean a standard (non-remedial) limit of 7.5 years. To be consistent with the SAP guidelines, the Pell Grant limit should be 7.5 years and should exclude up to one year of Pell Grants for remedial coursework.

- **Reinstate Pell Grant eligibility to recipients whose federal loans are discharged due to false certification or closed schools.**
  This change would ensure that these students' prior Pell Grant receipt does not keep them from pursuing further education.

[142] Scott-Clayton, Judith. 2012. *Information Constraints and Financial Aid Policy.* National Bureau of Economic Research. Working Paper 17811. http://www.nber.org/papers/w17811.

[143] Washington Higher Education Coordinating Board. 2006. *Washington State Need Grant Less-than-Halftime Pilot Project.* http://www.wsac.wa.gov/sites/default/files/SNG-LTHFullreport-PDF.pdf. Illinois Student Assistance Commission. 2001. *Initiative to Aid Illinois Adult Learners.* http://www.isac.org/dotAsset/eadbf229-cd07-477d-bae7-269d64daab1a.pdf.

Section 5: Student Loans

The current federal student loan program is too complex, its benefits are poorly targeted, and its terms are too arbitrary. Much of the complexity is a holdover from when banks received subsidies to make Stafford Loans with terms set and guaranteed by the government. The resulting rules shielded banks – but not borrowers or taxpayers – from risk. Now that these federal loans are made directly and more cost-effectively by the U.S. Department of Education (the Department), the entire student loan system can and should be streamlined and improved.

From the myriad types and terms of different loans through to the repayment process, it can be hard to figure out how federal student loans work. Consider just the main source of undergraduate loans since July 2010: the Direct Stafford Loan program. There are "subsidized" and "unsubsidized" Stafford Loans, each with different interest rates, eligibility criteria, and treatment of interest during school and periods of deferment, with separate caps on how much a student can borrow each year and cumulatively. The vast majority (82%) of undergraduates with subsidized loans also have unsubsidized loans,[144] so some of their loans accrue interest while they are in school and some do not, and their loans may have different interest rates even when they took them out at the same time.

Subsidized loans currently provide students with valuable benefits, including a low fixed interest rate and no interest accrual while they are in school.[145] However, these benefits are not well targeted, as high-income students may qualify just because they attend a high-cost college, and most students with subsidized loans also have unsubsidized loans.

All Stafford Loans offer flexible repayment plans, as well as loan deferments and forbearances, yet more than one in eight student loan borrowers is defaulting within three years of entering repayment.[146] The consequences of defaulting on a federal loan can follow borrowers for the rest of their lives, ruining their credit, making it difficult to buy a car or rent an apartment, and limiting their job prospects. They may also face garnished wages, seized income tax refunds, and diminished Social Security checks.

Finally, the Stafford Loan interest rates are currently set by Congress, and are not tied in any way to the cost of lending. As a result, while interest rates on 10-year Treasury notes are currently two percent, the subsidized loan interest rate is scheduled to double this July from 3.4 percent to 6.8 percent. In today's unusually low interest-rate environment, the federal loan

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[144] Calculations by TICAS on data for 2011-2012 from the College Board, *Trends in Student Aid 2012*, Table 6a, http://bit.ly/155ZtyV.

[145] For more information about both subsidized and unsubsidized Stafford Loans, see http://studentaid.ed.gov/types/loans/subsidized-unsubsidized.

[146] For the most recent federal loan cohort default rates at the time of publication, see http://1.usa.gov/OtVLKB.

program generates billions of dollars a year for the government, but when interest rates in the market rise, it could cost the government billions of dollars.

Reform is clearly and urgently needed. Our loan recommendations aim to better support access and success while containing costs and risks for both students and taxpayers. To achieve those goals, we propose simplifying the loan program, improving the targeting of benefits, containing debt burdens, and encouraging wise borrowing. Our recommendations include:

- Provide a single undergraduate student loan with no fees, a low in-school interest rate, and a fixed rate in repayment that is never too much higher than the rate on loans being offered to current students.
- Streamline and improve federal loan repayment options.
- Improve the timing, content, and effectiveness of student loan counseling.
- Better prevent student loan defaults.
- Reform the student loan collections process.
- Strengthen consumer protections for private student loan borrowers.

Provide one simple, affordable undergraduate loan program.

We propose replacing the current Stafford Loans with one simple, affordable undergraduate loan. Our recommended changes are designed to simplify the loan program, ensure that loans both appear and are affordable for borrowers, and better align the cost of the loan for the student with the costs for the government. There is no way to perfectly balance all three of these goals. However, what we propose is an important step forward on each front, focused on making federal student loans a more effective tool for ensuring access and supporting success while containing risk for both the student and the taxpayer. This undergraduate student loan program would have the following components.

- **One Loan.**
  Specifically, we recommend that there be one federal loan for undergraduate students, in place of the subsidized and unsubsidized Stafford Loans available today. A single loan will be much easier for borrowers to understand and keep track of, and for schools and the Department to administer. This loan – which we refer to in this paper as the One Loan – has an interest rate that is lower while the student is in school and higher by a set margin, but capped, when the borrower enters repayment. The interest rates are tied to the government's cost of borrowing and designed to offset the cost of the loan program, rather than being arbitrarily set by Congress. To help borrowers who go to school when interest rates are unusually high, One Loans have a built-in form of insurance that keeps their rates from ever being too much higher than the rate on loans being offered to current students.

- **Fixed interest rates and no fees.**
  One Loans have fixed interest rates and no fees. Fixed rates are important to provide

certainty, predictability and reassurance to students, many of whom have never borrowed before and may not fully understand the consequences of variable rates. The recent mortgage crisis demonstrated all too clearly that millions of Americans with mortgages did not understand the risks of variable rates, with terrible consequences for both them and our nation's economy. Fixed interest rates also further distinguish One Loans, which are a form of financial aid, from other financial products such as credit cards and private loans. Most private loans have variable, uncapped rates and require a cosigner.[147] The private loans that offer fixed rates will almost certainly have higher interest rates than One Loans for all borrowers except those who have, or whose cosigners have, pristine credit. At the height of the lending boom in 2007-08, a majority of private student loan borrowers had not taken out as much as they could have in federal loans first, underscoring the need to clearly distinguish federal student loans from private loans.[148]

The One Loan's fixed rate is tied to the government's cost of borrowing in the year the loan is disbursed. For instance, the interest rate on all loans disbursed in a given school year might be set based on the interest rate on the one-year Treasury bill or 10-year Treasury note at the final auction preceding June 1 of that year. Students who take out One Loans each year that they are in school may end up having loans with different interest rates, depending on the market conditions each year. However, all the other terms of their One Loans would be the same.

There is no reason for the new loan to have fees, which are a remnant from the bank-based guaranteed loan program and add unneeded complexity to the loan. The fixed interest rate will be set to cover the cost of One Loans without needing to add supplemental fees. How the fixed in-school and out-of-school rate for each loan will work is described immediately below.

- **Low in-school interest rate.**
  The in-school interest rate on One Loans is based on the government's actual cost of borrowing when the loans are made. The rate for new loans would take effect each year on July 1 and apply to all loans issued through June 30 of the following year. For instance, if it were tied to the 10-year Treasury note, the in-school rate on One Loans for the current school year would be less than two percent. The in-school rate applies while the borrower is enrolled at least half time and during a six-month grace period after they leave school, similar to the usual timing of the interest subsidy on subsidized Stafford Loans. Having a lower interest rate when students are in school is intended to encourage them to stay enrolled and complete their education, knowing that their interest rate will rise if they stop out or drop out. Lower in-school interest rates also help encourage the use of federal loans over private loans or other types of financing

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147 U.S. Consumer Financial Protection Bureau and U.S. Department of Education. 2012. *Private Student Loans: Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce.* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

148 TICAS. 2011. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.

available to consumers with limited or no credit histories. Charging a low in-school rate, rather than charging no interest, while the student is enrolled is designed both to lower the cost of providing the loan and to discourage students from dragging out their time in school.

- **Higher, but capped, out-of-school rate.**
  The One Loan's out-of-school interest rate is set as the in-school rate when the loans were taken out, *plus* a fixed margin designed to cover the cost of the loan program, including the interest-rate insurance described below, loan forgiveness and discharge, and administrative costs. For example, imagine a One Loan with an in-school interest rate of three percent, based on the government's cost of borrowing that year. If, for illustration purposes only, the repayment rate were set at the in-school rate plus two percentage points, it would have an out-of-school interest rate of five percent. The out-of-school rate, while higher than the in-school rate, must be low enough to ensure that federal loans are – and look like – financial aid in contrast to other types of financing such as private loans.

  The out-of-school interest rate on One Loans will be subject to a universal cap, like Stafford Loan interest rates under current law and in the past. Currently the maximum Stafford Loan interest rate is 6.8 percent and the cap has as been set as high as 9.0 percent in the recent past.[149] A universal cap helps protects consumers from extremely high rates in the economy and reinforces the differences between federal loans and commercial financial products. For example, if the universal cap were seven percent, the in-school interest rate were six percent, and the repayment rate set at the in-school rate plus two percentage points, the One Loan would have an out-of-school interest rate of seven percent, because the universal cap would keep the rate from rising above seven percent.

- **Interest-rate insurance.**
  The One Loan has an important new feature: a form of insurance that prevents interest rates from ever being too much higher than the rate on loans being offered to current students. This feature addresses the major disadvantage of fixed rates for borrowers, without requiring refinancing or consolidation. Borrowers with unsubsidized Stafford Loans today face this issue. While a 6.8 percent once seemed like a good deal, in the current low-interest rate environment, it is very high. To prevent borrowers from getting stuck with high fixed rates when market rates decline significantly, the interest rate on One Loans will reset to a lower fixed rate when interest rates in the economy drop substantially from when the loan was issued. For illustration purposes only, the interest rate insurance might prevent outstanding One Loans from having a rate that is more than two percentage points above the rate on loans being offered to current students. If a borrower had a One Loan with an out-of-school interest rate of 6.5 percent, and interest rates dropped so that the One Loans to current students had an out-of-school rate of 3.8 percent, the borrower's interest rate would automatically drop from 6.5 percent to 5.8 percent, so that the rate was no more than two percentage points above the

[149] For more information about historical interest rates on federal student loans, see http://www.gpo.gov/fdsys/pkg/FR-2013-01-25/pdf/2013-01423.pdf and http://www.gpo.gov/fdsys/pkg/FR-2013-01-25/pdf/2013-01421.pdf.

current rate.

The interest rate on affected One Loans would not rise back up, even if rates in the economy increase. This helps borrowers who go to school when interest rates are unusually high, while avoiding the uncertainty and risk of a variable rate for all borrowers. We believe this interest-rate insurance, which has some similarities to existing financial instruments (e.g., swaptions[150]), can be provided at a reasonable cost to both borrowers and taxpayers, and incorporated into the fixed margin in the out-of-school interest rate. The cost of this feature will depend on the selected interest rate margin, universal cap, and the specifics of the insurance.

- **Interest-free deferments for Pell Grant recipients.**
  In addition to the One Loan's low in-school rate, universal interest-rate cap, and interest-rate insurance, which apply to all borrowers, the One Loan provides additional protection to borrowers from low-income families. Pell Grant recipients who take out One Loans would be eligible for interest-free deferments during periods of unemployment and economic hardship, just as with subsidized Stafford Loans currently.[151]

  Subsidized Stafford Loans do not accrue interest while the borrower is in school, during the six-month grace period,[152] or when payments are deferred for certain reasons after the borrower leaves school, including during periods of unemployment and the first three years in IBR if income-based payments are less than monthly interest. However, as mentioned above, these valuable benefits are not well targeted for several reasons: high-income students may qualify for subsidized loans just because they attend a high-cost college; and the vast majority of students with subsidized loans also have unsubsidized loans, which accrue interest during these periods.

  The One Loan better targets these valuable benefits to the borrowers who most need them, when they need them most. Borrowers who received Pell Grants, by definition, come from low-and moderate-income families and are therefore much less likely to have family members who can support them during periods of unemployment or low earnings. The One Loans provide interest relief on all loans held by Pell recipients, rather than just some of their loans, when they are unemployed or their incomes are too low to cover the interest in an income-based repayment plan.

- **Retain current loan limits.**
  The One Loan has the same aggregate loan limits as Stafford Loans: $31,000 for dependent undergraduates and $57,500 for independent undergraduates. As discussed in Section 1, student loans have become a fact of life for more and more Americans, and there is widespread and understandable concern about high and pervasive debt levels. Federal loan limits provide a necessary signal to students and colleges about how much

[150] For information on this example, see http://en.wikipedia.org/wiki/Swaption.
[151] For more information about existing deferments for federal student loans, see http://studentaid.ed.gov/repay-loans/deferment-forbearance.
[152] The grace period interest subsidy was temporarily eliminated for loans issued in 2012-13 and 2013-14.

borrowing might be too much. The higher loan limits for independent students rightly recognize that these students have greater financial responsibilities and may need to borrow more to stay and succeed in school.[153]

Some have suggested raising the current loan limits, while others have suggested lowering them, but the data do not support either suggestion.[154] As mentioned earlier, average debt for 2011 graduates of public and nonprofit four-year colleges was well below the aggregate limits—the average including private loans was $26,600 for the two-thirds who borrowed, and one-third of graduates had no student debt.[155] The majority of undergraduates who borrow private education loans could have borrowed more in federal student loans before turning to the riskier private market.[156] Finally, colleges already have the authority to limit or deny loans for individual students on a case-by-case basis.[157]

The Department of Education should, however, analyze the potential effects of prorating federal student loans by attendance status. Unlike Pell Grants, federal loans are not prorated based on a student's attendance status. In other words, students enrolled half time receive a prorated portion of the Pell Grant that students enrolled full time receive, but may receive the same loan amount as a full-time student. Students who take out full loans but make only part-time progress may be at an increased risk of dropping out and defaulting. Students who attend college part time are less likely to complete a degree or certificate,[158] and failure to complete a degree or certificate is one of the strongest predictors of future default.[159] They may also be at greater risk of exhausting their loan eligibility before completing their degree. Prorating loans would involve reducing student eligibility for federal loans at a time when college is getting harder to afford, but it is possible that it could help encourage students to enroll in more courses per term, thereby completing a degree and reducing their risk of default. Given both the risks and the potential benefits, such a change warrants careful analysis and consideration.

Streamline and improve federal loan repayment options.

We have identified several ways to simplify and improve federal loan repayment options to help borrowers manage their debt, and reduce the financial distress and defaults that undermine the goals of increased enrollment and completion. There is even more complexity on the repayment

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[153] For more information on independent students, see http://bit.ly/XXgAh5.
[154] For more information, see *Over-Borrowing" Not the Problem at For-Profit Colleges:* http://bit.ly/Xo5KTh and *Data Show No Evidence of "Over-Borrowing" at Community Colleges*: http://bit.ly/WYyge7.
[155] TICAS. 2012. *Student Debt and the Class of 2011.* http://projectonstudentdebt.org/files/pub/classof2011.pdf.
[156] TICAS. 2011. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.
[157] TICAS. 2012. *Making Loans Work.* http://projectonstudentdebt.org/files/pub/Making_Loans_Work.pdf.
[158] U.S. Department of Education, National Center for Education Statistics. 2011. *Six-Year Attainment, Persistence, Transfer, Retention, and Withdrawal Rates of Students Who Began Postsecondary Education in 2003–04.* http://nces.ed.gov/pubs2011/2011152.pdf.
[159] Gross, Jacob P.K., Osman Cekic, Don Hossler, and Nick Hillman. 2009. *What Matters in Student Loan Default: A Review of the Research Literature*. Journal of Student Financial Aid. Vol. 39 No. 1. http://bit.ly/VPFaV5. Education Sector. 2011. *Degreeless in Debt: What Happens to Borrowers Who Drop Out.* http://www.educationsector.org/sites/default/files/publications/DegreelessDebt_CYCT_RELEASE.pdf.

side of the federal loan process than on the borrowing side. The number of repayment options and the variation in eligibility requirements, costs, and benefits can be overwhelming, even for those working in the field. With so many choices and variables, comparisons can become unwieldy and confusing, and borrowers may be more likely to end up in plans that do not fit their needs or goals. However, having some well-designed choices, combined with timely and effective counseling, can help borrowers find a good fit for their own situation, stay in repayment, and avoid default.

Let borrowers make one loan payment for all their federal loans.
To reduce complexity and make it easier to stay current on their loans, we recommend that borrowers be able to make a single payment that covers all of their federal loans. Currently, this can only be accomplished though a separate consolidation process, which is a significant bureaucratic hurdle for borrowers and has tradeoffs that are not in every borrower's best interest.[160] Borrowers should not have to consolidate their loans just to avoid making multiple payments to multiple servicers on their federal student loans each month.

Base repayment plan eligibility on total federal loan debt.
The "standard" repayment plan for unconsolidated federal loans is currently a 10-year plan. Borrowers are automatically enrolled in this plan if they do not actively choose a different one before their first payment.[161] If borrowers owe more than $30,000, they may be able to choose an "extended" 25-year plan instead, but only if they owe that much within one loan program.[162] For example, if they owe $31,000 in Federal Family Education Program (FFEL) Loans or $31,000 in Direct Loans, they may qualify for the extended plan. But if they owe $15,000 in Direct Loans and $16,000 in FFEL Loans, they do not qualify. In contrast, total federal student loan debt, along with the borrower's income, is used to determine eligibility for income-based repayment plans, in which borrowers pay for up to 20 or 25 years.[163] Meanwhile, borrowers who combine their loans into a Direct Consolidation Loan have access to "standard" repayment plans that gradually increase from 10 to 30 years[164] depending on the borrowers' total federal loan debt.[165] Any signal to borrowers about optimal repayment periods, if one were ever intended, gets lost in all this complexity, and what is optimal to one borrower may not be for another.

We recommend instead that all borrowers have access to repayment plans based on their *total* federal student loan debt, with incrementally longer repayment periods available to those with larger total debt. Making these repayment options consistent for all loans would greatly

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160 For more information about federal loan consolidation, see http://studentaid.ed.gov/repay-loans/consolidation.
161 U.S. Department of Education. 2010. *Exit Counseling Guide for Federal Student Loan Borrowers*. www.direct.ed.gov/pubs/exitcounselguide.pdf.
162 For more information about the extended repayment plan, see http://studentaid.ed.gov/repay-loans/understand/plans/extended.
163 All of the borrower's Direct and FFEL loans count in determining eligibility for IBR and Pay As You Earn, with the exception of Parent PLUS and consolidation loans that repaid Parent PLUS loans. For more information, see http://studentaid.ed.gov/repay-loans/understand/plans/income-based and http://studentaid.ed.gov/repay-loans/understand/plans/pay-as-you-earn.
164 Depending on total educational indebtedness, a borrower with a Direct Consolidation Loan has access to a "standard" repayment period of 10, 12, 15, 20, 25, or 30 years in a non-income-based plan. For more information, see the U.S. Department of Education. *Direct Consolidation Loans*. Table entitled "Standard and Graduated Repayment Plan Repayment Periods." http://loanconsolidation.ed.gov/examples/repyperiod.html.
165 The Direct Consolidation Loan program defines total debt for this purpose as total Direct Loan debt plus FFEL debt up to the same amount as the Direct Loan total. For more information about the definition, see http://1.usa.gov/WBrewl.

simplify the process for borrowers, especially when paired with improved loan counseling that helps them identify their priorities and see which plan is the best fit. Borrowers who want to reduce the overall cost of their debt by paying it down faster will be able to select shorter repayment plans and make prepayments without penalty, as they can now. Borrowers who want assurance that their monthly payments will remain affordable, given their income, will have access to a streamlined income-based plan, as discussed in detail below. Additionally, borrowers who want all their payments to count towards Public Service Loan Forgiveness will always be able to choose a 10-year payment plan.[166]

Currently, as mentioned above, borrowers who do not select a repayment plan are automatically placed in a 10-year plan, making the 10-year plan the "default" plan. A 10-year plan has significant benefits for borrowers *if* they can afford the monthly payments, which are higher than the monthly payments in longer plans. Given the growth in student debt levels over the past generation, a 10-year plan may be increasingly unrealistic for many borrowers.[167] Automatically enrolling borrowers in this plan, regardless of their total debt levels, could be setting some borrowers up to fail.

Nevertheless, there are trade-offs between shorter and longer repayment plans. Longer repayment periods provide lower monthly payments, but also cost borrowers more over the life of the loan. The best plan for one borrower may not be the best for another borrower. The decision of which repayment plan is most appropriate for any given borrower – whether made by the individual or by the Department through the selection of a "default" plan – is important and needs to be considered carefully. As we discuss later in this section, loan counseling should be improved to help borrowers decide which plan is best for them. The Department should also carefully analyze data on borrowers' repayment plan choices and outcomes – including their ability to make payments and total amount paid – to determine whether a 10-year plan remains the best option for borrowers who do not actively select another plan. The Department should also consider the broader implications of changing the default repayment plans for borrowers, colleges, and taxpayers.

Give all borrowers access to a single, improved income-based repayment plan.
When Congress created the Income-Based Repayment plan (IBR) for federal loans in 2007, it was a major step forward for student loan borrowers.[168] TICAS, through its Project on Student Debt, developed the policy proposal that laid the groundwork for IBR.[169] We first consulted with stakeholders on all sides and conducted an in-depth analysis of debt burdens and repayment plans. This analysis found that protections and options for borrowers with high debt relative to

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166 For more information about the payments that qualify for Public Service Loan Forgiveness, which include 10-year payments and payments made in income-based plans, see http://1.usa.gov/OjQu3p.
167 For example, in 2008, one in 10 graduates from four-year colleges had at least $40,000 in student loans, up from just three percent in 1996 (using constant 2008 dollars). TICAS. 2010. *High Hopes, Big Debts.* http://bit.ly/YN6wZ5.
168 IBR was created as part of the College Cost Reduction and Access Act of 2007: http://1.usa.gov/UQfQy7.
169 "Petition for Rulemaking to Amend Title 34, Sections 682.210, 685.204, and 685.209 of the Code of Federal Regulations." 2006. Signed by American Student Assistance, the College Board, College Parents of America, the Council for Opportunity in Education, Great Lakes Higher Education and Affiliates, The Howard Center for Family, Religion and Society, TICAS' Project on Student Debt, State Public Interest Research Groups, and the United States Student Association. http://projectonstudentdebt.org//files/File/Petition_to_ED_5.2.06.pdf.

their income were inadequate, inconsistent and inaccessible.[170] With America's higher education system increasingly reliant on student loans, and the consequences of default so severe and long-lasting, students were bearing too much of the risk to ensure access or support success. We developed a "Plan for Fair Loan Payments" that called for affordable payments based on income and family size, coverage of both Direct and FFEL loans, and a light at the end of the tunnel with forgiveness after 20 years of income-based payments. These goals were supported by thousands of students, higher education leaders, loan industry representatives, civil rights groups, Republicans and Democrats in Congress, and organizations representing parents, college counselors, and others.[171]

Thanks to the broad coalition that helped make the case for a solution, IBR became available to all federal loan borrowers in July 2009.[172] Despite the absence of much publicity or borrower outreach in the first few years of the program, more than 1.3 million borrowers were enrolled in IBR by the winter of 2012.[173] IBR caps monthly payments at a manageable share of income and forgives any principal or interest that remains after 25 years of payments. To qualify, borrowers must have a "partial financial hardship," defined as a debt-to-income ratio that makes a 10-year payment unaffordable. Required payments can be as low as $0 for borrowers with very loan incomes, and payments rise incrementally with income. Payments are capped at 15 percent of "discretionary income," which is defined as adjusted gross income (AGI) minus 150 percent of poverty for the borrower's family size.[174]

In recent years, the number of repayment options similar, but not identical, to IBR has grown. In early 2010, Congress passed the president's proposal to expand IBR for future borrowers.[175] Starting in 2014, new borrowers will be able to qualify for a lower monthly payment and shorter forgiveness period than the current IBR program provides: 10 percent of discretionary income and 20 years, instead of 15 percent and 25 years. In the fall of 2010, President Obama announced a new Pay As You Earn plan to give an estimated 1.6 million current students and recent graduates access to the same lower payment cap and shorter forgiveness period, with the goal of offsetting the recession's effect on their job prospects and earnings.[176] To qualify for Pay As You Earn, students must have borrowed their first loan after September 31, 2007 and received at least one federal loan disbursement after September 31, 2011. Pay As You Earn became available to eligible borrowers in December 2012 through regulatory additions to a preexisting program called Income-Contingent Repayment (ICR), which is only available for borrowers with Direct

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[170] TICAS. 2006. *Addressing Student Loan Repayment Burdens: Strengths and Weaknesses of the Current System.* http://ticas.org/pub_view.php?idx=103.
[171] For more information about the Plan for Fair Loan Payments and support for its goals, see http://bit.ly/VLVIbj.
[172] TICAS. June 30, 2009. Press release. "New Federal Income-Based Repayment Plan Goes Into Effect July 1." http://ticas.org/files/pub/July_1_IBR_Alert.pdf.
[173] U.S. Department of Education. January 2, 2013. *Homeroom: The Official Blog of the U.S. Department of Education.* "New Student Loan Repayment Option to Help Recent Graduates." http://www.ed.gov/blog/2013/01/new-student-loan-repayment-option-to-help-recent-graduates/.
[174] For more information about IBR, see http://studentaid.ed.gov/repay-loans/understand/plans/income-based and http://IBRinfo.org.
[175] The White House. 2010. *Ensuring That Student Loans are Affordable.* http://1.usa.gov/d32TEd.
[176] The White House. October 25, 2011. Press release. "We Can't Wait: Obama Administration to Lower Student Loan Payments for Millions of Borrowers." http://1.usa.gov/t63akG. See also TICAS. December 20, 2012. Blog post. "Pay As You Earn Now Available to Help New College Grads." http://views.ticas.org/?p=956.

Loans.[177] ICR, which is still available, provides less relief than IBR in most cases. Direct Loan borrowers in any of these repayment plans who *also* work for public or nonprofit employers may have their loans discharged after just 10 years of payments, through the Public Service Loan Forgiveness plan Congress created at the same time as IBR.[178]

We recommend consolidating the well-intentioned but highly complex mix of currently available income-based plans -- current IBR, IBR for new borrowers in 2014, Pay As You Earn, and ICR -- into one new and improved income-based plan. Borrowers will no longer have to figure out which plans they qualify for or which of their loans will be covered by which payment cap or forgiveness period. Those already enrolled in IBR, Pay As You Earn, and ICR would have the option of staying put or switching to the new plan. For the purposes of this paper, we refer to the new plan as Pay As You Earn 2 (PAYE2).

To simplify, strengthen, and improve access to income-based payments, PAYE2 will:

- **Be available to all borrowers, regardless of their debt or income level, whether their loans are Direct or FFEL, or when they borrowed.**
  This will make it much easier for borrowers who want the assurance of manageable payments to enroll whenever it makes sense for them, whether it is before they make their first payment, after they have hit a rough patch, or when they are concerned about what the future will bring. Rather than requiring borrowers to have a certain debt-to-income ratio to enroll, borrowers with higher income relative to their debt will simply make larger payments as determined by the plan's sliding scale. This is already the case for those whose incomes rise substantially after they entered an income-based plan. If borrowers have access to even lower monthly payments in another plan, and that is more important to them than the assurance of income-based payments, they need not enroll in PAYE2.

  Enabling all borrowers to enroll in PAYE2 will likely require adjustments in some aspects of income-based plan design, such as the treatment of accrued interest, when to capitalize interest and how much, and whether and how borrowers can exit and re-enter PAYE2. Further study is needed to determine optimal approaches. These changes will affect the benefits and risks of widespread enrollment in PAYE2.

- **Ensure payments never exceed 10 percent of income while better targeting benefits.**
  In its current design, Pay As You Earn has undeniable benefits for low- and moderate-income borrowers, but it may also result in some high-income borrowers getting substantial forgiveness when they could well afford to pay more. PAYE2 includes two adjustments that better target benefits while assuring that monthly payments never exceed 10 percent of the borrower's income and avoiding arbitrary cliffs, in which borrowers in very similar situations get very different benefits. These adjustments are:

[177] For more information about ICR, see http://studentaid.ed.gov/repay-loans/understand/plans/income-contingent.
[178] For more information about Public Service Loan Forgiveness, see http://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service and http://www.ibrinfo.org/what.vp.html#pslf.

- *Gradually phase out the "income exclusion" for higher income borrowers.* PAYE2, like IBR and Pay As You Earn, calculates monthly payments based on the borrower's "discretionary income" –AGI minus an "income exclusion" to protect income needed to cover basic living expenses. Currently, in IBR and Pay As You Earn, the income exclusion is 150 percent of the poverty level for the borrower's household size. Based on this definition, a borrower with a family of four and an AGI of $40,000 has $34,575 protected for basic living expenses. The family therefore has a discretionary income of $5,425, or $452 per month, so payments set at 10 percent of discretionary income would be $45 per month.[179]

  However, as borrowers' incomes rise, it becomes increasingly unnecessary to shield a share of their earnings. Borrowers with very high incomes are able to devote a larger share of their total incomes to loan payments and still have sufficient funds left over to cover basic necessities, such as food and housing. As a result, PAYE2 gradually phases out the income exclusion for borrowers with AGIs between $100,000 and $250,000, so that borrowers with AGIs of $250,000 or more would have their monthly payments calculated as 10 percent of their total AGI. Borrowers with AGIs below $100,000 would not be affected, and monthly payments for all borrowers would never be greater than 10 percent of their total income. The AGI levels at which the phase-out begins and ends would be indexed to inflation to ensure fairness over time.

- *Cap all monthly payments at 10 percent of income.* Currently, in IBR and Pay As You Earn, some borrowers can end up paying less than 10 percent of their income due to a certain cap on their monthly payments. This occurs if, after entering IBR or Pay As You Earn, the borrower's income rises high enough that he no longer has a "partial financial hardship" (i.e., his debt-to-income ratio has declined so much that that a 10-year payment is now affordable). When this occurs, his payments are capped at the monthly amount he would have had to pay had he entered a 10-year standard repayment plan when he entered IBR. For some high-income borrowers, this cap will be lower than 10 percent of their income. Removing the current 10-year-payment cap and instead capping payments at 10 percent of income better targets income-based repayment benefits to those who need them and prevents high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.

- **Provide forgiveness after 20 years of payments.** As we have long recommended, any debt remaining after 20 years of income-based payments should be discharged. This will make it easier for borrowers to see the light at the end of the tunnel and let them focus on saving for retirement and their children's education before the next generation is in college. The changes to payment determinations described above better target the forgiveness available after 20 years,

[179] Calculations by TICAS based on data from the U.S. Department of Health and Human Services, "2012 HHS Poverty Guidelines," http://aspe.hhs.gov/poverty/12poverty.shtml.

because higher income borrowers will be more likely to pay off all or most of their debt within that period.

Make it easy for all borrowers in income-based plans to keep their income information up to date.

Regardless of how many income-based plans there are, there is a need to further improve the process through which borrowers provide updated income information to their loan holders. Currently, borrowers in income-based plans must provide tax or other income information each year to avoid reverting to non-income-based payments that may be much higher than they can afford. Recent improvements require that borrowers be notified before they have to submit information and make it easier for some borrowers to submit it to their servicer.[180] Additionally, in late 2012, the Department launched a user-friendly tool that lets borrowers electronically transfer their own tax information from the Internal Revenue Service (IRS) into an online form, both to apply for income-based plans and to update their income information.[181] Unfortunately, this process is only available to borrowers who have filed an IRS 1040 form. Borrowers with incomes too low to owe federal income tax may not have a 1040 form to draw from, requiring them to go through extra steps to verify their income. As a result, borrowers with the greatest need for income-based payments may have the hardest time continuing to qualify for them.

Just as we have recommended in Section 2 for the parallel system now used to prepopulate the FAFSA with applicants' 1040 data, the income verification process for PAYE2 should also draw on earnings data in borrowers' W-2 forms to simplify the process for all borrowers. In addition, borrowers should be able to give the Department advance permission to access their AGI and W-2 information for some period of time (e.g., five years), as they could until recently for IBR and ICR,[182] to reduce the risk of inadvertently missing a deadline.

Do not treat forgiven loan balances as taxable income.

Borrowers currently enrolled in IBR, ICR, and Pay As You Earn, as well as those who would be enrolled in our proposed PAYE2 plan, can have their loan balances forgiven after 20 or 25 years (depending on the program) of qualifying payments. As explained in more detail in Section 6, these forgiven loan amounts should not be treated as taxable income. Treating discharged loans as taxable income creates a tax liability that most recipients will be unable to afford, discourages enrollment in income-based repayment plans, and is inconsistent with the treatment of other discharged loans.

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[180] For more information, see the U.S. Department of Education. November 1, 2012. Federal Register Notice, Docket ID ED–2012–OPE–0010. Final regulations on the Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program. http://www.gpo.gov/fdsys/pkg/FR-2012-11-01/pdf/2012-26348.pdf.

[181] U.S. Department of Education. December 21, 2012, updated January 11, 2013. Electronic Announcement. "Loan Servicing Information - Availability of Pay As You Earn Repayment Plan and Electronic IBR/Pay As You Earn/ICR Repayment Plan Request." http://ifap.ed.gov/eannouncements/122112LSIPayAsYouEarnPlanIBRnICR.html.

[182] See, for example: "William D. Ford Federal Direct Loan Program Income Contingent Repayment Plan & Income-Based Repayment Plan Consent to Disclosure of Tax Information." OMB No. 1845-0017. Available online, as of February 10, 2013, at http://loanconsolidation.ed.gov/forms/icr.pdf. Borrowers used this form to authorize the IRS to provide their income information for five years (2008-2012). It expired on June 30, 2012.

Improve the timing, content, and effectiveness of student loan counseling.

Federal law and regulations require entrance and exit counseling for any student who receives a federal loan.[183] Entrance counseling has the potential to help students optimize their borrowing and better understand the risks and benefits, and exit counseling has the potential to help students select an appropriate repayment plan and avoid default. However, the timing and content of required counseling must be improved to better help students borrow wisely, complete college without burdensome debt, and repay their loans. With common-sense modifications and more research on what works, loan counseling can more effectively inform crucial decisions about borrowing and repayment.

Loan counseling should be conducted when it is most likely to have an impact.
That means entrance counseling should happen *before* students commit to borrowing. Currently, entrance counseling can occur after the promissory note is signed, as long as the counseling comes before the first loan disbursement. This timing problem can and must be fixed. Also, while entrance counseling is only required when students first borrow, interim counseling should take place at key points when borrowers are likely to benefit, such as when they have borrowed over a certain amount or sought certification of a private loan.

Loan counseling must be individualized based on the borrower's specific situation and needs, not just disclose general information and options.
Entrance counseling could give students an estimate of their total debt burden if they borrow the amount they are seeking in each year they plan to be in school, and the resulting monthly and total payments under different plans. Exit counseling could ask students about their plans and preferences and point them toward specific repayment plans based on this information. For instance, if a student has borrowed a small amount and has secured a job with sufficient pay, the counseling might encourage her to select a 10-year fixed payment plan to minimize the total amount she will pay over the life of the loan. On the other hand, if the student has borrowed a large amount and is unsure how much she is likely to earn, the counseling might highlight income-based repayment as a way to keep her payments affordable. Currently, counseling does not have to be tailored to the individual student's situation and can, for example, use average loan amounts rather than the amount the student has actually borrowed.

The entrance and interim loan counseling should include warnings about the risks of private loans and discourage students from considering them if they have not exhausted their federal loan options.
Students need to understand the protections and benefits that come from federal loans, including set and predictable interest rates, flexible repayment plans, deferment options, and forgiveness programs, *before* they take out a private loan. To the extent possible, exit counseling should include any private loan debt so students can select a repayment plan for their federal loans based on an understanding of their total debt, including any private loans.

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[183] For information on current loan counseling requirements, see the U.S. Department of Education. *2012-13 Federal Student Aid Handbook*. Volume 2, Chapter 6. http://ifap.ed.gov/fsahandbook/attachments/1213FSAHbkVol2Ch6.pdf. For information on the federal regulations regarding loan counseling, see http://bit.ly/XtgttB.

Finally, all loan counseling should be consumer tested and improved based on the feedback, and ongoing analysis should be conducted of counseling's impact on student decisions. For instance, existing data systems could be used to assess the impact of variations in entrance, interim, and exit counseling on student enrollment, persistence, borrowing, repayment, and default rates. Such analysis could be used to continually improve the counseling to better support student success, prevent loan defaults and unwise or unnecessary borrowing, and reduce the burden of student debt by helping students choose appropriate repayment plans.

Strengthen consumer protections to support smart borrowing, prevent default, and reduce financial distress for borrowers with federal and private loans.

For federal loan borrowers

As a form of financial aid, federal student loans provide many important consumer protections that are not required of private education loans or other types of financing. Examples include: discharges under circumstances such as school fraud, school closure, severe and permanent disability, or death; income-based repayment plans that assure affordable payments and a light at the end of the tunnel; deferments and forbearances that let borrowers temporarily suspend payments without becoming delinquent or paying additional fees; and an opportunity to reenter repayment after default. Such policies are supposed to prevent or reduce defaults, unfair treatment, and extreme financial distress for borrowers who used federal loans to help pay for their own or their child's education. Unfortunately, the federal loan system does not work as well as it should to protect borrowers in challenging circumstances. We suggest the following changes to help reduce red tape for distressed, disabled, or defrauded federal loan borrowers and better reduce and prevent defaults. While far from comprehensive, these recommendations touch on several important areas for improvement in ways that address the interests of both borrowers and taxpayers.

Respond to signs of financial distress in ways that can prevent default.

- *Ensure that borrowers receive key information about their repayment options not only before they make their first payment, but also when their payment patterns indicate likely financial distress.* For example, a dozen members of Congress recently urged the Secretary of Education to alert borrowers to the availability of IBR and related plans as soon as those borrowers have been delinquent, in forbearance, or in economic hardship or unemployment deferment for more than 60 days.[184] Despite efforts to make repayment more manageable, default rates have risen even among those who entered repayment after IBR became available.[185] Borrowers struggling to keep up with monthly payments clearly need this information and related counseling. Once distressed borrowers are aware of IBR and how it could help them, they might also benefit from information

[184] September 28, 2012 letter to Education Secretary Arne Duncan from 12 members of the U.S. House of Representatives. For more information, see http://schwartz.house.gov/issue/higher-education.
[185] TICAS. September 28, 2012. Press release. "Student Loan Default Rates Show Continued Borrower Distress: Income-Based Repayment Plan Could Help More Borrowers Avoid Default." http://ticas.org/files/pub//Release_CDRs_092812.pdf.

about extended repayment plans, deferments, forbearances, and conditions for cancellation.

- *Automatically enroll severely delinquent borrowers in an income-based repayment plan*. It takes at least nine months of nonpayment to default on a federal student loan. The federal loan promissory note should require borrowers to give the Department permission to access their IRS information if they miss at least six consecutive payments. Using their income and family size, the Department could then determine what their income-based payment would be.[186] If it were less than their current payment, the Department would notify the borrower and, unless they chose another plan, automatically enroll the borrower in the income-based plan. For borrowers with very low incomes, income-based payments may be as little as $0, and income-based payments will be lower than 10-year payments for most borrowers under financial strain. By enrolling them and engaging in follow-up contact and counseling, the Department may be able to prevent otherwise very likely defaults and the associated costs for both borrowers and taxpayers. Notification and ease of use will be essential to this policy's effectiveness, as borrowers need to know that their payment has been lowered and how and why to update their income and family size at least annually.

Determine why most delinquent borrowers are not successfully contacted before they default.
Data show that a significant number of borrowers who default were never successfully contacted by their lenders because their lenders did not have current contact information.[187] It will be very difficult to reduce default rates and help more borrowers enroll in affordable repayment plans if servicers and/or the Department lack accurate, up-to-date contact information for federal loan borrowers or functional systems for reaching them. The Department should conduct a study to determine the main causes of this serious problem, use the findings to identify needed changes, make any such changes that are within its authority, and recommend that Congress make additional changes if necessary.

Reconsider the use of private debt collectors for federal student loans.
Currently, the federal student loans collections process is almost entirely in the hands of private debt collection agencies.[188] These debt collectors are given the authority to act on behalf of the lender or guarantor in everything from rehabilitation of a defaulted loan to information about loan discharges to negotiating loan compromises. Because their contracts with the Department of Education provide bigger rewards for collecting larger dollar amounts, these debt collectors have a disincentive to inform borrowers of their rights or to set reasonable and affordable payment amounts based on the borrowers' financial circumstances, as required by law.[189] Given

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[186] Income would be adjusted gross income (AGI) or, if no tax form were available for the past two tax years, wages from W-2 forms. While the family size definition may not be identical to the U.S. Department of Education's definition, it is a proxy under these circumstances and can be amended by the borrower. For further discussion of the family size definition issue, see Section 2.

[187] U.S. Department of Education, Office of Federal Student Aid. Webinar, presented November 18, 2010. *Delinquency and Default Prevention Training*. http://www2.ed.gov/offices/OSFAP/training/materials/defaulttranscript.pdf. P. 27.

[188] U.S. Department of the Treasury. 2009. *Fiscal Year 2008 Report to the Congress:* U.S. Government Receivables and Debt Collection Activities of Federal Agencies. http://www.fms.treas.gov/news/reports/debt08.pdf.
[189] Hechinger, John. March 25, 2012. "Obama Relies on Debt Collectors Profiting From Student Loan Woe." *Bloomberg News.*

the commission structure and conflicts of interest, it is not surprising that the National Consumer Law Center has found a remarkable amount of deceptive, unfair, and illegal conduct by private collectors involving federal student loans.[190] Recent news investigations have also documented such conduct and the underlying "boiler-room" business model.[191]

Collections should prioritize the interests of borrowers and taxpayers, not collection agencies. With the Department of Education spending more than $1.4 billion a year on commission-based contracts with private debt collectors, an examination of whether outsourcing is the most effective or appropriate approach is long overdue.[192] In 2009, the IRS conducted an extensive review of its private collections contracts and moved to bring the function in-house.[193] The Treasury Department is responsible for the collection of debt owed to the federal government but has delegated to the Education Department the authority to collect on defaulted student loans.[194] We recommend that the Treasury Department withdraw the delegation of its authority for a randomly selected number of defaulted loans for the purpose of studying whether taxpayers' and borrowers' interests would be better served by collecting all defaulted federal student loans by trained Treasury employees rather than by private debt collectors.

Protect income that borrowers need for basic necessities.
Collection and rehabilitation policies for federal student loans should not force defaulted borrowers to choose between making a loan payment and keeping a roof over their head. In recognition that borrowers must pay for basic necessities like food and shelter before they can put anything towards their student loans, IBR payments are $0 for borrowers with income below 150 percent of the poverty level for their family size, with loan payments rising only as their income increases. For both ethical and practical reasons, the same minimum income protection should be built into federal loan collections and rehabilitation policies.

TICAS and other student and consumer organizations have long recommended that the nine "reasonable and affordable" payments required to rehabilitate a defaulted loan follow the IBR formula, but with a minimum payment of $5 instead of $0.[195] Since this issue was raised during negotiated rulemaking in 2012, the Department has reported that many of their collections contractors are using IBR as the initial threshold for "reasonable and affordable" payments. To build on this apparent progress, this practice must be formalized and required in all cases.

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http://www.bloomberg.com/news/2012-03-26/obama-relies-on-debt-collectors-profiting-from-student-loan-woe.html.
[190] Loonin, Deanne. National Consumer Law Center. Testimony before the U.S. Senate Judiciary Subcommittee on Administrative Oversight and the Courts, hearing entitled, "The Looming Student Debt Crisis: Providing Fairness for Struggling Students." Delivered March 20, 2012. http://www.judiciary.senate.gov/pdf/12-3-20LooninTestimony.pdf.
[191] Hechinger 2012. Martin, Andrew. September 8, 2012. "Debt Collectors Cashing In on Student Loans." *The New York Times*. http://www.nytimes.com/2012/09/09/business/once-a-student-now-dogged-by-collection-agencies.html?pagewanted=all.
[192] Martin 2012.
[193] Internal Revenue Service. March 5, 2009. Press release. "IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts: IRS Employees More Flexible, More Cost Effective**."** http://www.irs.gov/uac/IRS-Conducts-Extensive-Review,-Decides-Not-to-Renew-Private-Debt-Collection-Contracts.
[194] As specified in 31 USC 3711g: "For purposes of this section, the Secretary of the Treasury may designate, and withdraw such designation of debt collection centers operated by other Federal agencies. The Secretary of the Treasury shall designate such centers on the basis of their performance in collecting delinquent claims owed to the Government."

[195] See, for example, public comments by TICAS at http://ticas.org/files/pub/TICASNegReg_Comments_5.20.2011.pdf.

Wage garnishment and offsets of tax refunds and Social Security benefits should also be subject to this approach to income protection.

Rethink default penalties to ensure that distressed borrowers have a way out.
While there should clearly be some penalties associated with defaulting on a federal student loan, they should not be designed to keep borrowers without financial means in default indefinitely, with already unmanageable debt just continuing to mount. For example, collection fees of up to 25 percent are currently added to what borrowers owe when they default, even if the actual costs of the collections activities were less.[196] These fees go to the private collection agencies discussed above. If a borrower went into default because she could not afford her loan payments, high fees make it even less likely that she will ever be able to get out of default. Another policy that can trap borrowers in default is limiting them to only one chance at rehabilitation. It is worth considering whether borrowers who redefault should be allowed to rehabilitate their loans more than once after some period of successful payments.

Ensure that borrowers who are abused or defrauded by a college can get relief.
The Department should use its full authority to enforce the law that relieves borrowers of debt resulting from illegal or abusive school practices. The "false certification" provisions in law are designed to offer relief for harmed students as well as to discourage illegal, abusive school practices. The law provides for the discharge of loans falsely certified by institutions and for the Secretary to recover the loans amounts from the schools and its affiliates. While the statutory authority is broad, the Department has interpreted these false certification provisions very narrowly, denying needed relief to borrowers who suffered harm at the hands of their school. Borrowers should be eligible for relief if, for example, a school improperly or falsely certifies a student's satisfactory academic progress,[197] enrolls students in career education programs that lack the programmatic accreditation necessary for employment in the occupation, enrolls students who do not speak English in programs taught only in English, or enrolls students with criminal records in programs that prepare them for employment in professions from which they are barred because of their criminal record. The regulations must be revised so that borrowers can count on relief from debts resulting from a school's harmful actions when there is reasonable evidence that the harm took place.[198]

For private loan borrowers

Private education loans are a much riskier way to pay for college than federal student loans. As mentioned earlier, interest rates on private loans are usually variable, like a credit card, and over the life of the loan will typically be much higher than the rates on federal student loans. Whether private loan rates are variable or fixed, lower income students often receive the worst rates and terms, and private loans do not have the important borrower protections and repayment options that come with federal loans. The following policy changes would help

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[196] U.S. Department of Education, Office of Federal Student Aid. "Debt Resolution: Collection Costs." https://www.myeddebt.com/borrower/collectionCostsNavigate.
[197] For examples of teachers being pressured to manipulate grades in order to retain students, see Field, Kelly. May 8, 2011. "Faculty at For-Profit Colleges Allege Constant Pressure to Keep Students Enrolled." *The Chronicle of Higher Education.* http://chronicle.com/article/Pawns-in-the-For-Profit/127424/.
[198] For more information, see TICAS' comments on false certification at http://ticas.org/files/pub/TICASNegReg_Comments_5.20.2011.pdf.

prevent students from unnecessarily taking out risky private loans, ensure that consumers have information they need to make wise borrowing decisions, and stop deceptive and predatory private lending practices.

Prevent unnecessary private loan borrowing by requiring school certification of private loans. The majority of undergraduates who borrow private education loans could have borrowed more in federal student loans before turning to the riskier private market.[199] Unfortunately, many students who borrow private loans – and the parents who co-sign these loans – do not understand the difference between federal and private loans until it is too late.[200] Requiring private lenders to confirm a borrower's eligibility with his or her school before disbursing the loan ensures the student is eligible for that loan and the loan amount. It also gives the school a chance to help the student make an informed borrowing decision. Before the credit crunch, about a third of all private loans to undergraduates were made *without* such school certification.[201] Currently, most lenders voluntarily ask schools to certify their private loans, but lenders are not required to do so, and changing credit conditions could once again create incentives to cut schools out of the loop. In addition, many schools do not take the opportunity to counsel students before certifying. Students, schools, and lenders, as well as the U.S. Consumer Financial Protection Bureau (CFPB) and Department of Education, have all endorsed requiring "school certification" of private loans, including notifying the student of any remaining federal aid eligibility before the loan is certified.[202] The CFPB could require such certification for all private loans, and legislation[203] introduced in 2013 (S. 113) would do so as well.

Treat private loans like other consumer debt in bankruptcy.
Since 2005, it has been much more difficult to discharge private education loans than credit cards and other consumer debt in bankruptcy, often leaving even the most destitute borrowers with no way out. A joint report to Congress from the CFPB and Department of Education found that this change coincided with rapid growth in questionable lending practices, compounding the risk to student borrowers.[204] It also found a lack of evidence to support industry claims that restricting bankruptcy rights improved loan prices or access to credit. House and Senate

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199 TICAS. 2011. *Private Loans: Facts and Trends.* http://projectonstudentdebt.org/files/pub/private_loan_facts_trends.pdf.
200 TICAS. 2011. *Critical Choices: How Colleges Can Help Students and Families Make Better Decisions about Private Loans*. http://projectonstudentdebt.org/pub_view.php?idx=766.
201 U.S. Consumer Financial Protection Bureau and U.S. Department of Education 2012.
202 See the December 10, 2009 letter signed by 25 organizations in support of mandatory certification. http://bit.ly/Y1qwUN. Also see the May 7, 2010 letter signed by lenders and others urging inclusion of mandatory school certification in the Senate financial reform bill, referenced in Lederman, Doug. May 11, 2010. "Unlikely Bedfellows on Student Loans." *Inside Higher Ed*. http://www.insidehighered.com/news/2010/05/11/certify.
203 U.S. Senator Dick Durbin. January 23, 2013. Press release. "As student loan debt surpasses $1 trillion, senators introduce legislation to address crisis." http://1.usa.gov/WxsVYM.
204 U.S. Consumer Financial Protection Bureau and U.S. Department of Education 2012.

legislation[205] would restore fair bankruptcy treatment to private loan borrowers and is supported by TICAS and a broad coalition representing students, consumers, and colleges.[206]

Enable private loan borrowers to refinance or modify their loans.
Borrowers who face unmanageably high payments on their private loans do not have access to lower payments through IBR or other federal repayment plans, and private lenders are not required to provide the types of repayment options and borrower protections that are built in to federal loans, such as unemployment deferments and forbearances without fees. Private loans typically have variable interest rates that are highest for the students and cosigners who can least afford them. Those who borrowed their loans at a high rate are often unable to refinance despite historically low interest rates in the economy, even if their current credit score would qualify them for a lower fixed or variable rate if they took out a loan today.[207] Keeping borrowers locked into high rates and high payments poses risks not only to their ability to meet basic needs, but also to retirement savings and homeownership, and to the broader economy as a result.[208] We recommend the CFPB and Congress develop standards for loan refinancing and/or modification to make private loan borrowers' debts more manageable.

Section 6: Tax Expenditures

As discussed in Section 1, current higher education tax provisions are too poorly timed and poorly targeted to efficiently increase college access or success. For these reasons, we recommend eliminating higher-education-specific tax benefits and redirecting the savings (more than $100 billion over the first five years) into Pell Grants and incentive funds for states and colleges to increase college access, affordability, and success.[209] However, there is strong bipartisan support for higher education tax benefits: the American Taxpayer Relief Act of 2012 (ATRA) included more than $90 billion (over a period of 10 years) in higher education tax benefits that would have otherwise expired, including the extension of two of the most

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[205] The Fairness for Struggling Students Act of 2013 (S. 114). Introduced January 23, 2013. http://thomas.loc.gov/cgi-bin/query/z?c113:S.114:. The Private Student Loan Bankruptcy Fairness Act of 2013 (H.R. 532). Introduced February 6, 2013. http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.532:.

[206] See the coalition letter to Senator Durbin in support of the Fairness for Struggling Students Act of 2013, available at http://projectonstudentdebt.org/pub_view.php?idx=872, and the coalition letter to Representative Cohen in support of the Private Student Loan Bankruptcy Fairness Act of 2013, available at http://projectonstudentdebt.org/pub_view.php?idx=871.

[207] U.S. Consumer Financial Protection Bureau. 2012. *Annual Report of the CFPB Student Loan Ombudsman.* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf. Pp. 6, 15, and 19-20.

[208] Chopra, Rohit. U.S. Consumer Financial Protection Bureau. Testimony before the Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection. Delivered July 24, 2012. http://1.usa.gov/OsqctM. U.S. Consumer Financial Protection Bureau. 2012. *Annual Report of the CFPB Student Loan Ombudsman.* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

[209] Joint Committee on Taxation. 2012. *Estimates Of Federal Tax Expenditures For Fiscal Years 2011-2015*. https://www.jct.gov/publications.html?func=startdown&id=4386. Pp. 40-41.

regressive and poorly targeted benefits: the student loan interest deduction and the tuition and fees deduction.[210]

If Congress is unwilling to eliminate the current higher education tax benefits and redirect the savings to Pell Grants, which more effectively and efficiently support college access and success, then we recommend dramatically streamlining and improving the targeting of higher education tax benefits. Specifically, *if* higher education tax benefits are to be retained, we recommend:

1. Streamline multiple higher education tax benefits into an improved American Opportunity Tax Credit (AOTC) that is better designed to increase college access and success.

2. Stop taxing forgiven or discharged student loans as income.

3. Stop taxing Pell Grants as income.

4. Better align eligibility for higher education tax benefits with eligibility for student grants and loans.

Streamline multiple higher education tax benefits into an improved American Opportunity Tax Credit (AOTC) that is better designed to increase college access and success.

Given the design of the American Opportunity Tax Credit (AOTC), research suggests it is the most likely of the current tax benefits to increase college access and success. This is because it provides some assistance to low-income students, who are more likely to be on the margin of attending and completing college due to financial need, liquidity constraints, and being more likely to be the first in their family to attend college. Research has also shown that low-income, minority, and community college students are more sensitive to tuition prices than other groups of students.[211] We therefore recommend extending and improving the AOTC by enhancing the benefits for low- and moderate-income students and for students attending community colleges. We pay for these changes by eliminating other less targeted, less effective tax benefits, including the tuition and fees deduction, student loan interest deduction, Lifetime Learning Credit and exclusion of earnings from Coverdell education savings accounts. The consolidation of tax benefits also greatly simplifies the tax code, which further increases the likelihood that the tax benefits will reach those who are at greatest risk of not starting or finishing college.

Our specific recommendations to improve the AOTC include:

- **Increase the AOTC's refundability.**
  The AOTC is the only higher education tax benefit that is refundable, enabling students

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[210] Joint Committee on Taxation. 2013. *Estimated Revenue Effects Of The Revenue Provisions Contained In An Amendment In The Nature Of A Substitute To H.R. 8, The "American Taxpayer Relief Act Of 2012," As Passed By The Senate On January 1, 2013.* https://www.jct.gov/publications.html?func=startdown&id=4497.

[211] Center on Budget and Policy Priorities. Unpublished memo, last revised November 2012.

and families with incomes too low to pay federal income tax to benefit from it. However, the AOTC is only 40 percent refundable (up to $1,000 per year). As a result, low-income students can receive a maximum of $1,000 per year and $4,000 over four years from the AOTC, while students from families with higher incomes can receive up to $2,500 per year and $10,000 over four years. This provides the greatest assistance to those who need it the least and whose behavior is the least likely to be affected by the tax benefit. The AOTC should be 100 percent refundable. If 100 percent refundability is too costly, then refundability should be increased as much as possible with the savings from tax reforms.

- **Replace the AOTC's four-year cap with a lifetime-dollar cap.**
  Currently, the AOTC provides up to a $2,500 credit per student per year for up to four years, for a maximum $10,000 total benefit. However, there is no evidence to suggest that the current four-year limit affects student behavior, and as noted above, it effectively caps the maximum total benefit at $4,000 for the lowest income students and $10,000 for the highest income students. In addition, the four-year time limit can reduce the benefit for those who have to enroll less than full time or take more than four years to finish. To provide the same maximum benefit to all students and provide a tax benefit to those completing their degree while working full time, the AOTC time limit should be replaced with a lifetime cap of $10,000.

- **Index the AOTC credit amounts and income limits to inflation.**
  The maximum annual benefits under the HOPE Credit and Lifetime Learning Credit are both indexed to inflation, while the AOTC's maximum annual benefit of $2,500 set in 2009 is not. Similarly, the income eligibility limits for the Hope Credit and Lifetime Learning Credit are both indexed to inflation, while the AOTC's income eligibility limits are not. The AOTC's annual and lifetime dollar caps, as well as the AOTC's income thresholds, must be indexed to inflation to prevent the AOTC's inflation-adjusted value and eligibility limits from declining over time.

- **Better target the AOTC to increase its impact on access and success.**
  While the AOTC provides greater benefits to lower income students than the non-refundable HOPE Credit, it also provides much greater benefits to higher income students and families as shown in the chart below.[212] Where eligibility for the HOPE Credit phases out for joint filers with incomes between $107,000 and $127,000 in 2013, eligibility for the AOTC phases out for joint filers with incomes between $160,000 and $180,000.[213]

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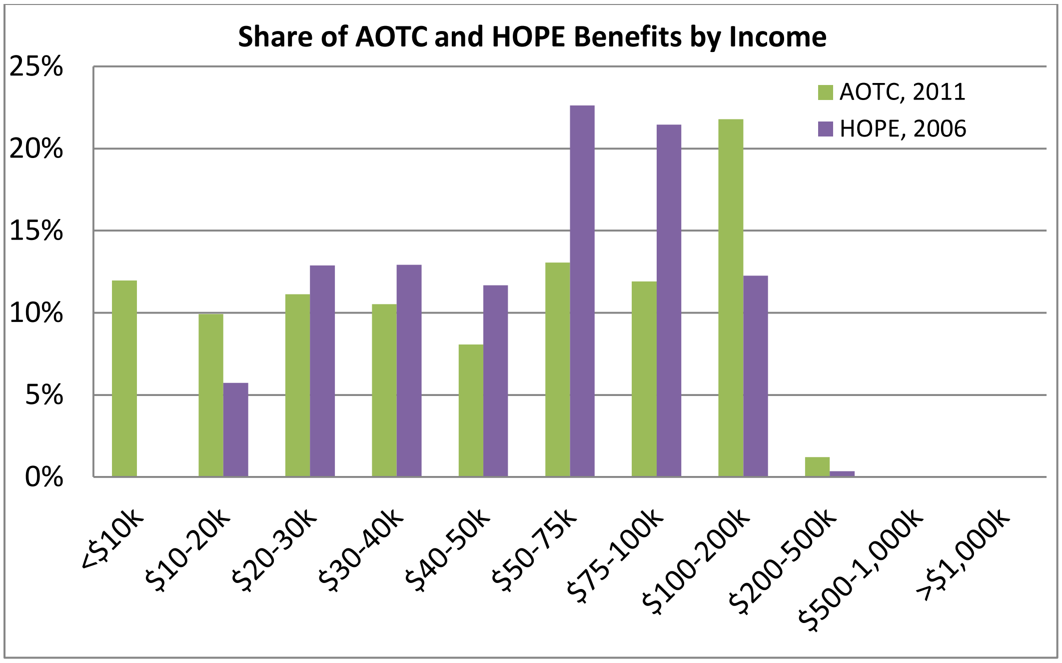
[212] Center on Budget and Policy Priorities. Unpublished memo, last updated November 2012. Calculations by the Center on Budget and Policy Priorities on data from the Tax Policy Center, Tables T11-0303 and T07-0249.

[213] The HOPE Credit phases out for single and head of household filers with incomes between $53,000 and $63,000, while the AOTC phases out for such filers with incomes between $80,000 and $90,000.



Note: Income categories are current dollars for the year in which the distribution is estimated.

In fact, dependent students with family incomes over $100,000 account for 15 percent of undergraduate students but receive 22 percent of AOTC benefits.[214] Students from such families are among the most likely to attend and complete college even without this benefit. Their families also receive the greatest tax benefits from 529 college savings accounts and are among the most likely to have such accounts.[215] To maximize the potential impact of the AOTC on college access and success, eligibility should phase out at the lower, preexisting HOPE Credit levels, indexed to inflation. If this is not viable, then at a minimum, AOTC eligibility should begin phasing out earlier—at $107,000 for joint filers like the HOPE Credits—while completely phasing out near or at the current maximum AOTC level ($180,000 for joint filers). This would help to prevent higher income families from receiving a disproportionate share of the AOTC and would better target benefits to those with the greatest need and whose college access and success is less assured.

- **Include transportation and child care costs as AOTC qualified expenses.**
  The U.S. Department of Education (the Department) and colleges include transportation and an allowance for child care in the full cost of college attendance, because students need to be able to get to and from campus (unless they are enrolled exclusively online) and arrange for the care of their children while studying. Both transportation and child care costs can be substantial for students who incur them and can account for a

[214] U.S. Department of Education, National Center for Education Statistics. 2010. *Web Tables - Profile of Undergraduate Students, 2007-08*. Table 3.5-A. "Percentage distribution of undergraduates, by dependency status and income level in 2006, and selected institutional and student characteristics: 2007–08." http://nces.ed.gov/pubs2010/2010205.pdf#page=72.

[215] Dynarski, Susan. 2004. *Who Benefits from the Education Savings Incentives? Income, Educational Expectations, and the Value of the 529 and Coverdell.* National Bureau of Economic Research. Working Paper 10470. http://www.nber.org/papers/w10470.pdf. U.S. Department of the Treasury. 2010. *The American Opportunity Tax Credit.* http://www.treasury.gov/resource-center/tax-policy/Documents/American-Opportunity-Tax-Credit-10-12-2010.pdf.

significant portion of the total cost of attendance. However, these costs are not currently considered qualifying expenses for the AOTC. To increase impact and consistency, we recommend that reasonable transportation and child care costs be considered qualifying expenses for the AOTC, just as they are eligible expenses for federal student aid. As a result, qualifying AOTC expenses would include tuition, fees, course-related books, supplies, equipment, and reasonable transportation and child care expenses. However, for students enrolled in entirely online programs, transportation expenses should *not* be considered qualified expenses for either federal student aid or tax benefits, and excluding such expenses may help reduce online student aid fraud as discussed in Section 2.

- **Adjust the AOTC benefit calculation to provide greater assistance to students with unmet need attending low-tuition colleges, such as community colleges.**
  Currently, the AOTC provides a 100 percent credit for the first $2,000 of qualified expenses and a 25 percent credit for the next $2,000 in expenses, for a maximum annual credit of $2,500 based on $4,000 of qualified expenses. In contrast, the HOPE Credit provides a 100 percent credit for the first $1,200 in expenses and a 50 percent credit for the next $1,200 in expenses, for a maximum credit of $1,800 per year. We recommend the AOTC benefit calculation be adjusted to cover 100 percent of the first $2,000 in expenses and 50 percent of the next $1,000, with the annual threshold amounts indexed to inflation. This change lowers the total out-of-pocket expenses necessary to receive the maximum AOTC to $3,000 from $4,000, providing a greater benefit to students with less than $4,000 in expenses. This would be especially helpful for lower income students who attend lower cost colleges (like community colleges) but still have significant unmet financial need after accounting for aid.

- **Study ways to deliver AOTC benefits at the time students incur expenses, rather than months later.**
  As discussed in Section 1, one of the major weaknesses of higher education tax benefits is that they are provided well after the costs of college are incurred. This reduces their impact on enrollment and persistence, especially for low-income students, who are the most likely to face cash constraints. As the economist Bridget Terry Long concluded, "While the [education] tax credits could encourage enrollment, the delay between the activity and receipt of the aid may reduce the likelihood of any effect…credits do not help individuals for whom liquidity is the reason they do not attend college."[216] Given the billions of dollars dedicated to higher education tax benefits, the Treasury and Education Departments should jointly study or commission research and analysis to identify ways to deliver tax benefits when students incur the costs of education, rather than months afterwards.

- **Eliminate other less targeted tax benefits and use the savings to improve the AOTC.**
  ATRA extended the AOTC for five years, through 2017, while making other less targeted

[216] Long, Bridget T. 2004. "The Impact of Federal Tax Credits for Higher Education: College Choices: The Economics of Where to Go, When to Go, and How to Pay For It." Pp. 101-168 in *College Choices: The Economics of Where to Go, When to Go, and How to Pay For It*, edited by Caroline M. Hoxby. Chicago, IL: University of Chicago Press. http://www.nber.org/chapters/c10099.pdf.

and less effective tax benefits permanent. We recommend eliminating the following less targeted tax provisions beginning in 2014:

- *Student Loan Interest Deduction.*
  This "above-the-line" deduction allows student loan borrowers with incomes up to $160,000 to deduct up to $2,500 in student loan interest payments each year, for the life of the loan, regardless of whether they itemize their taxes.[217] Because it is a deduction and is now permitted for the life of the loan, it is among the most regressive tax benefits, giving the greatest benefit to those with the highest incomes. It is also among the most poorly timed to influence students' decisions as it provides benefits years after the borrower has left school. Because it is a deduction, it also undermines the targeting of the Income-Based Repayment (IBR) and related federal loan repayment plans, which cap monthly loan payments based on the borrower's Adjusted Gross Income (AGI). This leads to a double benefit—the tax deduction lowers borrowers' AGI, which further lowers their monthly loan payments—that is greater for those with higher incomes and debts. If it is not viable to eliminate the deduction entirely, then at a minimum, the 2001/2012 expansions should be eliminated immediately and the underlying deduction phased out over a period of 10 years. Eliminating this deduction is estimated to save $20 billion over 10 years.[218]

- *Tuition and Fees Deduction.*
  This "above-the-line" deduction allows taxpayers with incomes up to $130,000 to deduct $4,000 spent on tuition and fees each year, and those with incomes between $130,000 and $160,000 to deduct $2,000, regardless of whether they itemize their taxes.[219] Because it is a deduction rather than a credit and has such high income limits, it is highly regressive. It is also unnecessary in light of the better targeted AOTC. Moreover, this benefit greatly adds to the complexity of the tax code because the deduction is per household, rather than per student like the AOTC, and filers cannot claim this deduction for one dependent and the AOTC for another dependent in the same year. This deduction should be

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[217] In 2013, the phase-out ranges are $130,000-$160,000 for joint filers and $65,000-$80,000 for single filers and heads of household. Prior to 2002, eligibility for the student loan interest deduction phased out at $60,000-$75,000 for joint filers and at $40,000-$55,000 for single filers and heads of households, indexed to inflation, and taxpayers could deduct interest payments for up to five years (60 months). The Economic Growth and Tax Relief Reconciliation Act of 2001 significantly raised the income limits and allowed deductions beyond five years. ATRA made permanent the expanded deduction, indexed to inflation.

[218] New America Foundation. 2013. *Rebalancing Resources and Incentives in Federal Student Aid*. http://newamerica.net/sites/newamerica.net/files/policydocs/NAF_Rebalancing%20Resources%20FINAL.pdf. P. 29.

[219] Joint filers with income below $130,000 and single filers and heads of household with income below $65,000 are eligible for a $4,000 deduction. Joint filers with income between $130,000 and $160,000 and single filers and heads of household with income between $65,000 and $80,000 are eligible for a $2,000 deduction. Filers with incomes above these levels are ineligible. ATRA retroactively restored the tuition and fees deduction, which had expired on December 31, 2011, and extended it through December 31, 2013.

allowed to expire as scheduled on December 31, 2013. Eliminating this deduction would save an estimated $7 billion over 10 years.[220]

- *Lifetime Learning Credit.*
  Tax filers can receive up to a $2,000 tax credit for each year that they pay tuition and fees for an undergraduate or graduate program or for individual courses taken to improve job skills. This credit may be claimed for an unlimited number of years but, unlike the AOTC, it can only be claimed once per tax return even if more than one person in the family is a student. Regardless of the amount of tuition and fees paid, the Lifetime Learning Credit and AOTC cannot be claimed for the same student in the same year. Eliminating the Lifetime Learning Credit would simplify the tax code by eliminating the need for families and students to evaluate which credit is appropriate and most beneficial for them, and it would also focus taxpayer resources on undergraduate degrees and certificate programs. If the four-year time limit for the AOTC is removed as we recommend, many students who are currently only eligible for the Lifetime Learning Credit will be able to claim the AOTC when they return to school to complete their degree later in life. Eliminating the Lifetime Learning Credit would save an estimated $28 billion over 10 years.[221]

  If policymakers want to retain tax benefits for graduate students, we recommend that graduate students be allowed to claim an AOTC of up to $1,000 per year up to the lifetime limit.[222] For example, if a student did not claim the maximum lifetime AOTC benefit for their undergraduate education, the student could claim the remaining amount during graduate school. This would particularly benefit older students who may not have had an opportunity to claim the HOPE Credit or AOTC when they were undergraduates. To maintain simplicity, the same income limits and indexing would apply to AOTCs for undergraduate and graduate education. To target resources to support degree completion and better prevent fraud, graduate students would need to be in a degree program and need to be enrolled at least half time. Of course, making any graduate students eligible for the AOTC would reduce the savings from eliminating the Lifetime Learning Credit.

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220 Estimate is compared to current tax policy, which includes the tuition and fees deduction. The Treasury Department estimates the cost of the tuition and fees tax deduction as $690 million in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. Note that this estimate would likely be somewhat affected by the ATRA.

221 The Treasury Department estimates the cost of the Lifetime Learning Credit as $2.8 billion in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. Note that this estimate would likely be somewhat affected by the ATRA.

222 For graduate education, the AOTC would cover 40 percent of the first $2,000 of qualified expenses and 20 percent of the next $1,000, with the threshold amounts indexed to inflation.

- *Exclusion of earnings from Coverdell savings accounts.*
  Taxpayers with incomes up to $220,000 may make after-tax contributions to an unlimited number of Coverdell savings accounts, in which interest accumulates tax-free and can be withdrawn tax-free if the funds are used for higher education or K-12 tuition, fees, room, or board.[223] This benefit is highly regressive because higher income taxpayers receive the greatest benefit from it and are the most likely to be able to establish a Coverdell account. It is also unnecessary given the generous tax treatment of 529 plans and prepaid tuition plans, and adds unnecessary complexity to the tax code. This benefit should be eliminated immediately for new contributions. If this is not feasible, then at a minimum, the 2001 expansions, which greatly increased the contribution limits and income limits and added savings for K-12 education, should immediately be repealed for new contributions. Eliminating this benefit is projected to save almost $1 billion over the next 10 years, and it will simplify the tax code and make it less regressive.[224]

Stop taxing forgiven or discharged student loans as income.

Current law treats forgiven or discharged student loan balances inconsistently. For example, the discharged amount is not treated as taxable income if the loan is discharged because a school closed before the student could complete the program or transfer, or if the loan is forgiven as a result of a public service loan forgiveness program. In contrast, the discharged loan is considered taxable income if it is discharged because the borrower died or became totally and permanently disabled, or if it is discharged after 20 or 25 years of income-based payments. This has led to confusing messages for borrowers, in which warnings about the taxability of forgiven debt far in the future may discourage those who most need the assurance of affordable payments right now. Treating discharged loan balances as taxable income creates a tax liability that most recipients will be unable to afford.

Discharged student loans should not be treated as taxable income, regardless of the reason for the discharge. Bipartisan legislation introduced in the 111th Congress (H.R. 2492) would eliminate the taxation of loans forgiven under Income-Based Repayment (IBR), Income-Contingent Repayment (ICR), and Pay As You Earn, ensuring true loan forgiveness for responsible borrowers. The bill was cosponsored by 47 Members of Congress from both sides of the aisle and was endorsed by more than 20 organizations and the Obama Administration.[225] Likewise, families whose children have died or become permanently disabled and unable to

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[223] The Economic Growth and Tax Relief Reconciliation Act of 2001 significantly increased annual contribution limits (from $500 to $2,000), increased the income eligibility phase-out range (from $150,000-$160,000 to $190,000-$220,000 for joint filers), and added the ability to use the accounts for K-12 education and to receive both Coverdell distributions and education tax credits in the same year (for different expenses). ATRA made these expansions permanent.

[224] The Treasury Department estimates the cost of the Coverdell exclusion as $70 million in 2011. Office of Management and Budget. Analytical Perspectives. Table 17-1. "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls.

[225] For more information, see http://projectonstudentdebt.org/initiative_view.php?initiative_idx=8.

work should not be hit with a tax bill that could come to thousands of dollars when their loans are discharged.

Stop taxing Pell Grants as income.

To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income as long as they are used for a qualified education expense. Under current law, Pell Grants may be used to cover any eligible cost of attendance, including tuition, fees, books, supplies, transportation, housing, or food. However, Pell Grants are *not* taxed as income if they are used to pay for required tuition, fees, books, supplies, or equipment, but they *are* taxed as income if they are used to pay for transportation, food, housing, or other eligible costs of attendance. The Joint Committee on Taxation reports that eliminating the taxation of Pell Grants would cost less than half a million dollars per year.[226] As such, eliminating the taxation of Pell Grants regardless of which expenses the grants cover would have a negligible impact on revenues while significantly simplifying the tax code and the benefit of Pell Grant receipt.

Moreover, this change would help more students with unmet financial need benefit from both Pell Grants and the AOTC. Currently, if students use their Pell Grants to cover fully their tuition, fees, and books, they will have no out-of-pocket qualified expenses for claiming the AOTC. Meanwhile, if students claim the AOTC for tuition, fees, and books paid for out of pocket, and use their Pell Grants to cover remaining costs of attendance, then they may face a tax liability. By removing the threat of any tax liability associated with Pell Grants, this interaction will no longer occur and more students, particularly at low-tuition institutions such as community colleges, will be able to benefit from both Pell Grants and the AOTC, just as students attending higher cost institutions already do. Community college students who receive Pell Grants have an average of more than $5,300 in unmet need after all grants,[227] and non-tuition expenses account for the *majority* of the cost of attending a community college.[228] Thus, by enabling students to use their Pell Grants for eligible non-tuition expenses without fear of negative tax consequences, many more students will be able to use the AOTC to help cover their tuition, fees, and books, and their Pell Grants to help cover other costs of attendance.

Legislation to prevent the taxation of Pell Grants and to better coordinate the AOTC with Pell Grants was introduced by Rep. Danny Davis in 2010 (H.R. 6488). This legislation was endorsed by the Association of Community Colleges, the Association of Community College Trustees, the American Association of State Colleges and Universities, the American Council on Education, the Center on Budget and Policy Priorities, The Education Trust, TICAS, the United States Student Association, and Young Invincibles.

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[226] Joint Committee on Taxation letter to the Honorable Danny K. Davis, July 21, 2010.

[227] Calculations by TICAS on data from the U.S. Department of Education, 2008 National Postsecondary Student Aid Study (NPSAS).

[228] The College Board. 2012. *Trends in College Pricing 2012.* Figure 1. http://trends.collegeboard.org/sites/default/files/college-pricing-2012-full-report_0.pdf.

Better align eligibility for higher education tax benefits with eligibility for student grants and loans.

Federal tax benefits have different eligibility requirements from federal student aid administered by the Department, greatly increasing complexity and reducing their effectiveness. Where possible, their eligibility requirements should be aligned.

In addition to the treatment of transportation and child care costs discussed above, another example of where eligibility for tax benefits should be aligned with the eligibility requirements for federal student aid involves a student's conviction for possessing or selling illegal drugs. If a student is convicted for the possession or sale of illegal drugs while receiving federal student aid from the Department, his or her eligibility for aid is *suspended* for that award year. Such students regain their eligibility in the next school year, or may regain it sooner by successfully completing an approved drug rehabilitation program or by passing two unannounced drug tests administered by an approved drug rehabilitation program. In contrast, students are rendered *permanently* ineligible for the AOTC and HOPE Credit if they have ever been convicted of a felony for possessing or distributing an illegal substance, even if it happened many years earlier when they were a minor or have completed their sentence. A recent study analyzed a similar policy in effect for federal aid from 2001 to 2007, and found it had a significant negative effect on college enrollment.[229] Few, if any, other provisions in the tax code are affected by one's criminal record. The current policy adds to the complexity of the tax code, is at odds with other higher education tax provisions, and is particularly inappropriate in the context of access to education and training needed for students to become productive, taxpaying citizens.

Section 7: Better Information

Students and their families need clear, timely, and comparable information about costs, financial aid, and outcomes to make wise decisions about where to go to college and how to pay for it. As discussed in Section 1, there are substantial differences between colleges' costs and outcomes. However, students currently lack the information they need to best determine which schools to apply to and attend. With easy-to-understand, comparable information, students and families will be able to better identify colleges that provide the best value and fit their specific needs. Increased transparency and awareness may also create pressure for colleges to keep their costs to students affordable and find ways to better support student success.

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[229] Lovenheim, Michael F. and Emily G. Owens. 2013. *Does Federal Financial Aid Affect College Enrollment? Evidence from Drug Offenders and the Higher Education Act of 1998.* National Bureau of Economic Research. Working Paper No. 18749. http://www.nber.org/papers/w18749.pdf.

Additionally, research suggests that we can increase the effectiveness of student financial aid simply by making sure that students are aware of it, what it will mean for them, and how to apply.[230] This means that we can increase the impact of the changes proposed in the previous sections of this paper by providing students and families with meaningful information when they most need it.

To provide students and families with the tools they need, when they need them, we recommend several improvements to increase the availability of relevant data and present that information in a more comparable and consumer-friendly format:

- Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates.
- Provide comparable and easy-to-understand information about financial aid, costs, and outcomes to students *early* in their college decision process.
- Require all colleges to use a standard format for financial aid award letters.
- Conduct consumer testing to ensure that information is presented in the most effective way.

Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates.

When deciding whether and where to go to college, students need to know their chances of graduating and their chances of graduating with debt, particularly high debt and/or risky private loan debt. Unfortunately, there are major limitations in the data currently available on student debt and completion.

For example, the U.S. Department of Education (the Department) does not currently collect college-level data on students' debt at graduation. Instead, the Department collects data on annual federal loan borrowing for all undergraduates (how much a college's students borrow in federal loans in a given year), cumulative debt when entering repayment (including students who dropped out as well as those who graduated), and annual federal and private loan borrowing just for first-time, full-time undergraduates.

Furthermore, there are currently no comprehensive college-level data available on private loan borrowing. As discussed in Section 5, private student loans are one of the riskiest ways to pay for college.[231] No more a form of financial aid than a credit card, private student loans typically have interest rates that are highest for those who can least afford them and lack the basic consumer protections and flexible repayment options of federal loans. The most recent available national data indicate that 33 percent of bachelor's degree recipients graduated with private

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[230] Long, Bridget T.. 2008. *What Is Known About the Impact of Financial Aid? Implications for Policy*. National Center for Postsecondary Research. Working Paper. http://www.eric.ed.gov/PDFS/ED501555.pdf.

[231] For more information, see http://projectonstudentdebt.org/privateloans.vp.html.

loans, with an average private loan amount of $12,550.[232] However, there is great variation in private loan borrowing among individual schools and different types of institutions. For example, private loans are most prevalent at for-profit colleges, where 64 percent of graduating seniors have private loan debt.[233] Improving information on private loans would help inform student decisions about where to go to college as well as illuminate the struggles that these borrowers face, identify areas that need policy attention, and inform future borrowers of the pitfalls of private educational lending.

The Department should immediately begin to collect data on student debt at graduation for all colleges, including both federal *and* private loans, and make those data available to students and borrowers. With minor enhancements to its annual survey of colleges, the Department could quickly begin collecting the average student debt at graduation, the share of that debt that is private loans, and the average annual private loan borrowing at each college that receives federal funding. Ultimately, the best way to provide accurate and comprehensive data, while minimizing the reporting burden for colleges, is for the Department to collect the data directly from lenders, using the system through which lenders currently report on every federal loan they hold. This would enable all borrowers to see all their loans, federal and private, in one place and receive loan counseling based on their total student debt, one of the key recommendations in the recent joint report to Congress by the Department and the Consumer Financial Protection Bureau (CFPB).[234] The CFPB and the Department should work together to improve the collection of private loan data from lenders and provide more accessible and comprehensive loan information to borrowers.

The Department should also begin publishing college-level cohort default rates (CDRs) that capture more of a student's repayment period (e.g., five years). As discussed in Section 3, current CDR measures only track the share of a school's borrowers who default on their federal loans within the first two or three years of repayment. Tracking borrowers for a longer period of time would provide a more comprehensive picture of how successfully students are able to repay their loans after leaving school. This alternative measurement would be for disclosure purposes only, providing information to consumers via tools such as the College Scorecard (discussed below), without compromising the timeliness of the shorter-term CDRs used for assessing a school's eligibility for Title IV funding.

Additionally, we recommend that the Department collect and make widely available college-level data on graduation rates for part-time students, transfer-in students, and Pell Grant

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[232] Calculations by the Project on Student Debt on data from the 2008 National Postsecondary Student Aid Study (NPSAS). Figures reflect the cumulative private (nonfederal) loan debt of bachelor's degree recipients who were U.S. citizens or permanent residents and graduated from a public, private nonprofit, or private for-profit four-year postsecondary institution during the 2007-08 academic year.

[233] Ibid.

[234] Consumer Financial Protection Bureau and U.S. Department of Education. 2012. *Private Student Loans: Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce.* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

recipients.[235] Currently, the Department only collects data on graduation rates for first-time, full-time students, which represent a small share of entering students at many colleges. Collecting graduation rate data for part-time students and transfer-in students, as recommended by two recent Technical Review Panels for the Department,[236] would significantly increase the percentage of students included in outcome measures. Additionally, to gauge the success rates of low-income students, the Department should collect the graduation rates of Pell Grant recipients and non-recipients. Colleges are currently required to disclose these rates, but a 2011 study found that many public and nonprofit four-year colleges were not providing the required disclosures and even when they did, the information was not in a form that would be useful for students and families.[237]

Provide comparable and easy-to-understand information about financial aid, costs, and outcomes to students early in their college decision process.

The timing of information matters. Improving the availability and quality of data is not helpful if students do not end up seeing that information until many of their major decisions about whether and where to go to college have already been made. To ensure that students and their families receive clear, comparable, and easy-to-understand information at crucial early stages in their college decision process, we recommend providing early estimates of aid eligibility, improving the FAFSA4caster tool, creating and promoting College Scorecards with key information on each college, and making net price calculators easier to find, use, and compare.

Annually notify households of likely financial aid eligibility based on their tax information. Early awareness of aid eligibility can help students and families plan for college, both academically and financially, and encourage them to apply for aid when the time comes. As discussed in Section 1, research has found that many students and families overestimate the cost of college and rule out colleges based on "sticker price" alone, without considering financial aid. Notably, students from lower- and middle-income families were more likely than affluent students to rule out colleges based on published prices.

Waiting for prospective students and their parents to seek out aid information means it may happen too late or not at all. Instead, as the Institute for Higher Education Policy and others have recommended, the Internal Revenue Service (IRS) and Department should work together to *proactively* provide households with annual estimates of federal aid eligibility, similar to the

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[235] For more information about our recommendations for improving data collection of completion measures, see http://projectonstudentdebt.org/files/pub/TICAS_comments_on_TRP37_CMSS_final_05-29-12.pdf.

[236] RTI International. 2012. *Report and Suggestions from IPEDS Technical Review Panel #37: Selected Outcomes of the Advisory Committee on Measures of Student Success. http://bit.ly/VEHaKt.* RTI International. 2012. *Report and Suggestions from IPEDS Technical Review Panel #40. Additional Selected Outcomes of the Advisory Committee on Measures of Student Success.* https://edsurveys.rti.org/IPEDS_TRP/documents%5CTRP40_Suggestions_final.pdf.

[237] The American Enterprise Institute and Education Sector. 2011. *The Truth Behind Higher Education Disclosure Laws.* http://www.aei.org/files/2011/11/07/-truthhighereddisclosurelaws_185621335060.pdf.

Social Security statements Americans receive each year.[238] Available tax information can be used to provide a snapshot of likely aid based on current financial circumstances. The more aid determinations rely on available tax information, as recommended in Section 2, the more robust these annual estimates will be.

For example, households with likely Pell Grant recipients could receive a message like, "If you or your child enrolled in college today, you would likely be eligible for at least $__ in grants, which do not have to be paid back. There are also other forms of financial aid available and it is easy to find out more." Wherever possible, the statements would be customized to include contextual information for the recipient's income range and state of residence, such as the estimated net price of attending the nearest public four-year and two-year colleges (or average net price for public colleges in the state), and how to find out more. The statement would also point to the improved FAFSA4caster (recommended below) for those not yet ready to apply to college, to the online FAFSA for those who are, and to college-level information available on the Administration's planned College Scorecards and on the College Navigator website.[239]

Improve the FAFSA4caster.

For those actively seeking aid estimates (perhaps in response to an annual notice as described above), the FAFSA4caster tool should make the most of available information and be as user-friendly as possible.[240] The FAFSA4caster is the Department's free financial aid calculator intended to provide students with an early estimate of their eligibility for federal financial aid. With practical improvements, it could quickly and easily provide a more refined estimate than the annual notice described above and directly link users to college-specific information. Users should be able to electronically transfer their own tax information into the 4caster, just as they already can when using the online Free Application for Federal Student Aid (FAFSA) and when applying for an income-based payment plan for federal student loans. By combining IRS data with answers to simple questions about the student's age or dependency status, the number of the family's children in college, and – if different from the IRS definition – the family's size, the 4caster will yield a more precise estimate of aid eligibility than one based on tax information alone.

For users who name a college or colleges they are interested in, the improved 4caster would automatically display the cost of attendance rather than requiring the user to look it up separately on College Navigator. It would also prominently display the estimated or average net price, followed by a list of options to cover college costs, link to the relevant College Scorecard or profile on College Navigator, and link to the college's net price calculator. Users who do not specify colleges in the 4caster would receive information on the nearest public four-year and two-year colleges (or averages for public colleges in the state). These changes, particularly if consumer-tested, will help make the 4caster much more useful for prospective students, their parents, college counselors, and others who students and families turn to for advice about college affordability.

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[238] Institute for Higher Education Policy. 2013. Making Sense Of The System: Financial Aid Reform for the 21st Century Student. http://bit.ly/14Khi5u.

[239] The U.S. Department of Education's College Navigator website is available at http://nces.ed.gov/collegenavigator/.

[240] The current FAFSA4caster is available at http://studentaid.ed.gov/fafsa/estimate.

Create and promote College Scorecards.
The College Scorecards currently being developed by the Administration are one-page forms illustrating the typical costs and student outcomes at each college receiving federal financial aid, compared to other colleges.[241] By presenting a limited set of data in an easy-to-understand format, these scorecards should help students quickly and easily understand their chances of completing, borrowing, graduating with high debt, and defaulting on their loans at a particular college. We support the development of this tool and recommend that the Department move quickly to finalize and promote it. Ultimately, however, our recommended improvements to the collection of data on student borrowing and completion must be made for this tool to provide the most useful information to students and families.

Make net price calculators easier to find, use, and compare.
To help students and families better gauge how much a particular college would cost them and where to apply, all colleges are now required by federal law to post online "net price calculators." These calculators provide early, individualized estimates of net price: the full cost of attendance minus grants and scholarships. This tool is a major step forward if implemented to achieve the goals Congress intended. Unfortunately, our research has found that many of these calculators are buried on college websites, have dozens of complicated questions, or generate estimates that are confusing, misleadingly optimistic, or unnecessarily out-of-date.[242]

Our recent report, *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* includes specific recommendations for colleges and the Department to make net price calculators more user-friendly, so prospective students and their families can make more informed decisions about which colleges to apply to and attend. For example, net price calculators should always:

- Be prominently posted on the financial aid and/or costs sections of college websites.
- Limit the number of detailed financial and academic questions, particularly those that are required, and make clear which questions are really required.
- Make it easy to find federally required estimates of the full cost of attendance, grant aid, and net price. The net price should always be the most prominent figure on the results page.
- Clearly differentiate any "self-help" (loans or student work) from grants and scholarships and limit recommended borrowing to federal student loans.

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[241] See a draft version of the College Scorecard at http://www.whitehouse.gov/sites/default/files/image/college-value-profile.pdf.

[242] TICAS. 2012. *Adding It All Up 2012: Are College Net Price Calculators Easy to Find, Use, and Compare?* http://ticas.org/files/pub/Adding_It_All_Up_2012.pdf.

Require all colleges to use a standard format for financial aid award letters.

For the millions of students who receive financial aid each year, award letters represent a crucial point in the long and often confusing financial aid process. For students entering college, this is the first point at which they and their families find out their actual cost of attending specific colleges, as well as each college's recommendations for how to cover that cost. Unfortunately, based on our research of more than 100 actual award letters, we have found that many do not display the full cost of attendance, do not calculate net price, fail to differentiate gift aid from loans or work-study, include confusing acronyms and terminology that are not defined, and inadequately explain deadlines and procedures.[243]

Standardizing the format and elements of award letters would make it much easier for students and families to compare the financial aid packages of different colleges. All award letters should include the following elements: the full cost of attendance at an institution (as defined by federal law), the total amount of grant aid, and the net price remaining after grant aid is subtracted. Grant aid should be clearly separated from self-help (loans and work-study). Award letters should use easy-to-understand language and provide information about required next steps and contact information for the financial aid office. These elements are similar to our recommendations for other consumer products, such as net price calculators, because it is helpful for students and families to see information presented in a consistent way throughout the college decision-making process.

We support bipartisan efforts to require all colleges that receive federal aid to use a standardized format for their award letters.[244] One example of a standardized model is the "financial aid shopping sheet," jointly developed by the Department and the CFPB.[245] This voluntary model format for financial aid offers is intended to make it easier for students and families to understand and compare how much they would need to save, earn or borrow to cover all college costs at each college to which they have been admitted. As of late 2012, more than 500 institutions enrolling 13 percent of all undergraduates have agreed to use the Shopping Sheet in the 2013-14 school year.[246] To allow students to easily compare costs, no matter where they apply, all colleges should be required to use a standard format.

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[243] TICAS. 2011. Public comments to the U.S. Department of Education on financial aid award letters. http://ticas.org/files/pub/TICAS_award_letters_comments_08-25-11.pdf.

[244] For example, see The Understanding the True Cost of College Act of 2012 (S. 3244). Introduced May 24, 2012. http://thomas.loc.gov/cgi-bin/query/z?c112:S.3244:.

[245] The Financial Aid Shopping sheet can be viewed at http://collegecost.ed.gov/shopping_sheet.pdf.

[246] U.S. Department of Education. November 15, 2012. *Homeroom: The Official Blog of the U.S. Department of Education.* November 15, 2012. "More than 500 Colleges Agree to Adopt Financial Aid Shopping Sheet." http://www.ed.gov/blog/2012/11/more-than-500-colleges-agree-to-adopt-financial-aid-shopping-sheet/.

Conduct consumer testing to ensure that information is presented in the most effective way.

Without consumer feedback and testing, well-intentioned efforts to calculate and provide meaningful data can go awry. The Department's recent efforts to define and disclose "on-time completion" rates are a case in point. To help prospective students understand their chances of success, all career education programs are required to disclose their on-time completion rates. However, the Department's current definition of "on-time completion" is problematic because it only includes students who complete the program, rather than all students who started the program. As student and consumer advocates have pointed out, this calculation is misleading and potentially harmful.[247] Testing the disclosures with prospective and current students could have identified the problem as well as more meaningful alternatives.

As this example makes clear, the format, content, and delivery method of all consumer products should undergo rigorous testing with the target population (e.g., students and their families). For the tools, resources, and disclosures discussed throughout this paper, consumer testing should include audiences with little or no college knowledge and experience. Such testing allows developers to evaluate how products are used and understood by the intended beneficiaries. User feedback may reveal a need to streamline or clarify information, provide additional context, or present a different set of data. For instance, focus groups recently held by the Center for American Progress suggested that the draft College Scorecard, discussed earlier in this section, could be improved by simplifying technical language and more clearly identifying its purpose.[248] Consumer testing should always be conducted before products are finalized, as well as to inform continuing improvements.

Appendix: Options to Pay for Recommended Reforms

As a nation, we have the resources to expand college access and increase student success by implementing the recommendations in this white paper, some of which require increased federal investment. For example, to close the projected Pell Grant "funding gap" over the next 10 years will require an estimated $23 billion.[249] Our proposal to significantly increase Pell

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[247] For more information, see the 2011 coalition letter urging the U.S. Department of Education to fix the on-time completion rate disclosures: http://ticas.org/files/pub/On-time_completion_rate_letter.pdf.

[248] Center for American Progress. 2012. *Improving the College Scorecard: Using Student Feedback to Create an Effective Disclosure.* http://www.americanprogress.org/wp-content/uploads/2012/11/CollegeScorecard-4.pdf.

[249] Calculations by the Center on Budget and Policy Priorities on data from the Congressional Budget Office (CBO), February 2013 baseline projections for the Pell Grant program, http://cbo.gov/sites/default/files/cbofiles/attachments/43912_PellGrants.pdf. Assumes Congress maintains the FY2012

Grants to restore their purchasing power and better target funds to the students who need them most will require billions more. However, this investment is not only sound, as supported by evidence, but necessary if we are serious about making college affordable for all students willing to study hard so that we can maintain and build an internationally competitive workforce.

Below is a list of common-sense reform options that would more than fully pay for the investments we recommend. Many of these options enjoy bipartisan support and have been endorsed by diverse organizations and economists. Although some have been proposed as ways to reduce the federal budget deficit, they generate enough savings that after offsetting the cost of our proposed policies, the bulk of the savings could still be directed at deficit reduction. This list of options makes clear that our recommended policies could be paid for without increasing the deficit, requiring harmful cuts in effective programs, or requiring increased income tax rates.

Note that all savings cited were estimated prior to enactment of the American Taxpayer Relief Act of 2012 (ATRA) and will be expected to change somewhat, but not dramatically, based on the new law. Also, tax expenditure cost estimates, where cited, are not exact estimates of the federal revenue that would be raised if a provision were eliminated, but provide a good sense of the scale of potential savings.

10-Year Savings	Reform Option
$580 billion-$1.2 trillion[250]	**Limit the tax benefit of itemized deductions to 15 percent or 28 percent.**

Currently, the highest income Americans receive the greatest benefit from tax deductions. For example, a $1,000 tax deduction reduces by $150 the taxes of a typical middle-income family in the 15 percent tax bracket while the same deduction can reduce the taxes of an individual earning $1 million a year by more than twice that amount - up to $396. Members of both parties have endorsed limiting the value of deductions, which would not only raise revenue, but also increase the fairness of our tax code. A diverse range of public interest organizations have called for limiting or eliminating tax deductions, including the Bipartisan Policy Center's *Restoring America's Future,* the National Commission on Fiscal Responsibility's *Moment of Truth,* and the

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discretionary appropriation for Pell Grants in FY2013 and that the Pell discretionary appropriation keeps pace with the Budget Control Act caps starting in FY2014.

[250] The Congressional Budget Office estimates that limiting the value of itemized deductions to 15 percent would raise $1.2 trillion over 10 years, relative to pre-American Taxpayer Relief Act of 2012 (ATRA) law. Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 151-152. The President's proposal to limit the value of itemized deductions to 28 percent would raise $584 billion during 2013-2022 relative to the Administration's baseline to return tax rates on income above $250,000 to Clinton-era levels, according to the Treasury Department. Office of Management and Budget. *The President's Budget for Fiscal Year 2013*. "Summary Tables." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/tables.pdf. P. 220. Because ATRA raised marginal tax rates for fewer taxpayers than was assumed in either of these estimates' baseline, the proposals would likely raise somewhat less revenue if enacted at current marginal tax rates.

Center for American Progress' *Budgeting for Growth*.[251] President Obama's Fiscal Year 2013 Budget proposed limiting income tax deductions to 28 percent, and Republican presidential candidate Mitt Romney proposed a firm cap of around $35,000, which would generate even greater savings than the President's proposal.[252] Others have proposed capping deductions at $25,000 or $50,000 per year. Another approach would be to phase out high-income taxpayers' personal exemptions and itemized deductions beginning at or below the levels set prior to 2001.

$352 billion[253] **Place a small tax on financial securities trades.**

The Wall Street Trading and Speculators Tax Act, introduced in 2012 by Senators Harkin, Sanders, Brown, and Whitehouse (S. 1787 and H.R. 3313), would place a small tax of three basis points (three pennies on $100 in value or 0.03%) on the trading of financial securities, including stocks, bonds, and other debt securities, except for their initial issuance. By setting the tax rate very low, the measure is unlikely to impact decisions to engage in productive economic activity. However, it could reduce certain speculative activities like high-speed computer trading. Such a policy is not unprecedented. Prior to 1966, the United States taxed all stock transactions and transfers, and during the Great Depression, Congress doubled the transaction tax rate to finance economic recovery initiatives. Currently, 30 other nations, including the United Kingdom, impose a transaction tax, and in each case the rate is higher than our proposed rate of 0.03 percent. Eleven European Union nations have agreed to move forward with a 10 basis point tax (0.10%). In the United States, this legislation is supported by a wide range of consumer, civil rights, and labor organizations, including Americans for Financial Reform, the Leadership Conference on Civil and Human Rights, Dēmos, and U.S. PIRG.[254]

$71 billion[255] **Impose a fee on large financial institutions.**

This option would assess an annual fee on large banks, thrifts, brokers, security dealers, and U.S. holding companies that control such entities. The fee would apply only to firms with consolidated assets of more than $50 billion. At 0.15 percent, the Congressional Budget Office (CBO) believes it is unlikely to cause financial institutions to significantly change their financial structure or activities, although it might affect an institution's tendency to take various risks.

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[251] OMB Watch. 2012. *Limit the deductions higher income households can claim on tax returns to 28 percent ($584 billion), or to 15 percent ($1.2 trillion).* http://www.ombwatch.org/files/budget/Revenue/ItemizedDeductions.pdf.

[252] Weisman, Jonathan. November 12, 2012. "Democrats Like a Romney Idea on Income Tax." *The New York Times*. http://www.nytimes.com/2012/11/13/us/politics/democrats-like-a-romney-idea-to-cap-tax-deductions.html.

[253] Joint Committee on Taxation revenue estimate for 2013-2021. Note that this estimate would likely be impacted somewhat by ATRA. For more information, see http://1.usa.gov/11q4wva.

[254] For more information, see http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2012/12/Summary-of-S.-1787.pdf.

[255] Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 201-202.

$60 billion[256] **Increase alcohol taxes.**

When adjusted for inflation, current excise tax rates on alcoholic beverages are at historically low levels. In the 1950s, excise taxes accounted for nearly half of the pretax price of alcohol; they now account for between 10 percent and 20 percent of the pretax price. The CBO estimates that taxing all types of alcohol at $16 per proof gallon would raise billions in new revenue by increasing the federal excise tax on a 750-milliliter bottle of distilled spirits by $0.40 (from about $2.14 to $2.54 per bottle), a six-pack of beer by $0.48 (from about 33 cents to 81 cents), and a 750-milliliter bottle of wine by $0.49 (from about 21 cents to 70 cents). As highlighted by the CBO, a study conducted for the National Institute on Alcohol Abuse and Alcoholism estimated that the external economic costs of alcohol abuse in the United States exceeded $100 billion in 1998—greatly exceeding the revenues from alcohol taxes. Research has consistently shown that higher prices lead to less alcohol consumption, even among heavy drinkers.

At least $42 billion[257] **Reform crop insurance.**

Organizations as diverse as the Heritage Foundation and Environmental Working Group have criticized the nation's crop insurance program for wasting taxpayer dollars and primarily benefiting insurance companies and large farmers who do not need assistance. Program costs are expected to hit record levels this year, at the same time that farmers' net incomes are expected to be the second highest in 30 years.[258] Bipartisan legislation, the Crop Insurance Subsidy Reform Act of 2012 (H.R. 6098), would reduce crop insurance premium subsidies to the levels set before the Agriculture Risk Protection Act of 2000, saving an estimated $42 billion over 10 years. This legislation has been endorsed by both taxpayer and environmental groups, including Taxpayers for Common Sense, the Environmental Working Group, Council for Citizens Against Government Waste, Americans for Tax Reform, the Taxpayers Protection Alliance, and the National Taxpayers Union. President Obama also has proposed cutting crop insurance subsidies and reducing the amount paid to insurance companies. However, his more modest reforms are expected to save only $4 billion over 10 years.[259]

Up to $172 billion[260] **End orders for obsolete spare parts and improve contracting and financial management at the Defense Department.**

Based on Government Accountability Office analyses, the Defense Logistics Agency, Army, Navy, and Air Force have been wasting billions of dollars purchasing items that go unused or

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[256] Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options.* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 193-194.

[257] Environmental Working Group. 2012. *Impact of Scaling Back Crop Insurance Premium Subsidies.* http://static.ewg.org/pdf/babcock_cropinsurancesubsidies.pdf.

[258] Nixon, Ron. January 15, 2013. "Record Taxpayer Cost Is Seen for Crop Insurance." *The New York Times.* http://www.nytimes.com/2013/01/16/us/politics/record-taxpayer-cost-is-seen-for-crop-insurance.html?_r=0.

[259] Ibid.

[260] U.S. PIRG and National Taxpayers Union. 2011. *Toward Common Ground: Bridging the Political Divide with Deficit Reduction Recommendations for the Super Committee.* http://www.uspirg.org/sites/pirg/files/reports/USPIRG_Toward_Common_Ground.pdf.

were never required (as much as 50% more than required). According to a report by the U.S. PIRG and National Taxpayers Union, eliminating orders for obsolete spare parts and supplies would save nearly $37 billion over the next 10 years, and implementing acquisition reforms identified by the bipartisan Defense Acquisition Panel would save up to an additional $135 billion.

Up to $37 billion[261] **Eliminate or reform tax-exempt bonds for private nonprofit colleges and universities.**

The organization Young Invincibles recently recommended eliminating or reforming the tax-exempt bonds for private educational institutions because they provide a windfall to high-income bond purchasers. Private nonprofit colleges and universities issue tax-exempt bonds, called "qualified 501(c)(3) bonds," to raise capital for building construction or repay previously issued bonds.

$21 billion[262] **Tax private equity and hedge fund income like other income.**

Many private-equity and hedge fund managers receive the bulk of their income through "carried interest," which is currently taxed at a maximum rate of 20 percent, rather than as income, which is taxed at a progressive rate up to 39.6 percent for those with the highest incomes. Taxing carried interest as income would increase both tax fairness and revenue. Income that partners received as a return on their own capital contribution would not be affected. Legislation to tax carried interest as income has passed the House of Representatives three times and has been repeatedly included in the Obama Administration's budget proposals.

$17 billion[263] **Reduce federal student loan costs through Direct Loan consolidation.**

The New America Foundation has proposed creating a permanent federal student loan consolidation program that would enable borrowers with bank-based federal student loans, made under the Federal Family Education Loan (FFEL) program, to consolidate them into the more efficient Direct Loan program. Because Direct Loans save taxpayers money compared to FFEL Loans, borrowers could be offered an interest rate reduction as an incentive to consolidate, lowering the cost to borrowers and saving taxpayers an estimated $17 billion.

Up to $20 billion[264] **Eliminate or phase out the student loan interest deduction.**

As discussed in Section 6, the student loan interest deduction is poorly targeted and timed, providing the greatest tax benefits to those with the highest incomes, years after they have left

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261 Estimate based on Young Invincibles. 2012. *The Student Perspective on Federal Financial Aid Reform*. http://younginvincibles.org/wp-content/uploads/2012/11/Final-White-Paper-All-Edits.pdf. This estimate would likely be affected by ATRA.

262 Congressional Budget Office. 2011. *Reducing the Deficit: Spending and Revenue Options*. http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf. Pp. 157-158. Note that ATRA would be expected to reduce this estimate somewhat.

263 New America Foundation. 2013. *Rebalancing Resources and Incentives in Federal Student Aid*. http://bit.ly/VxXyS4. P. 15.

264 Ibid. P. 29.

school. In addition, the deduction undermines the targeting of benefits in the Income-Based Repayment (IBR) and related federal student loan repayment programs because they are based on a borrower's Adjusted Gross Income (AGI), which is reduced by the student loan deduction. Eliminating the deduction immediately would save up to $20 billion over 10 years.

$7 billion[265] **Repeal the tuition and fees tax deduction.**

As discussed in Section 6, the tuition and fees deduction is also poorly targeted and is unnecessary given the expansion of the American Opportunity Tax Credit (AOTC). It also adds significant unneeded complexity to the tax code because taxpayers cannot take both the AOTC and the deduction in the same year, and the AOTC is per student while the deduction is per tax return. This deduction was extended through the end of 2013 and should be allowed to expire at that time.

$28 billion[266] **Repeal the Lifetime Learning Credit.**

As discussed in Section 6, the $2.8 billion invested per year in the Lifetime Learning Credit would have a greater impact on college enrollment and would be better targeted if it were invested in Pell Grants or the AOTC. Unlike the AOTC, the Lifetime Learning Credit can be used for graduate degree programs. If there is a need to provide a tax credit to offset the cost of graduate education, it would be simpler and better targeted to provide a limited AOTC for graduate education than to maintain a separate tax credit with different eligibility and income limits. In contrast to the AOTC, which is per student, the Lifetime Learning Credit is per tax return, further adding to the complexity of offering both credits.

$3 billion[267] **Reduce loan rehabilitation fees and funds retained by guaranty agencies.**

When guaranty agencies rehabilitate a defaulted federal student loan made under the Federal Family Education Loan (FFEL) program, they currently are compensated a substantial amount. When a FFEL loan is successfully rehabilitated, the guaranty agency sells the loan to a FFEL lender. The agency must then remit those funds to the federal government. However, they are able to retain 37 percent of the original defaulted loan amount as compensation, and half of that total (18.5%) is charged to the borrower's account as a collection fee. Eliminating the guaranty agencies' retention portion and requiring them to remit the entire balance to the U.S. Department of Education (the Department) will save taxpayers more than $3 billion. Furthermore, reducing the collection fee to 16 percent would significantly reduce the perverse

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[265] Estimate is compared to current tax policy, which includes the tuition and fees deduction. The Treasury Department estimates the cost of the tuition and fees tax deduction as $690 million in 2011. Office of Management and Budget. 2012. *The President's Budget for Fiscal Year 2013.* Table 17-1: "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. This estimate would likely be affected by ATRA.

[266] The Treasury Department estimates the cost of the Lifetime Learning Credit as $2.8 billion in 2011. Office of Management and Budget. 2012. *The President's Budget for Fiscal Year 2013.* Table 17-1: "Estimates Of Total Income Tax Expenditures For Fiscal Years 2011-2017." http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls. This estimate would likely be affected by ATRA.

[267] Congressional Budget Office. 2012. *Preliminary estimate of mandatory changes in the Senate FY13 Labor-HHS-Education Appropriations Bill.*

incentive of rewarding lenders for default and rehabilitation as opposed to default prevention. It would also make loan rehabilitation more manageable for borrowers. This proposal was included in the President's Fiscal Year 2013 budget and the Senate's Fiscal Year 2013 Labor, Health and Human Resources, and Education appropriations bill. Both use the savings to fund Pell Grants.

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