Brief

Status Quo: Divergent Financial Aid Systems Yield Disparate Outcomes

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The financial aid system for low-income students mostly revolves around extending availability of student debt, while higher-income students benefit from asset-based investments, largely administered through the tax code. The result of this divide is seen in poorer educational outcomes for disadvantaged students and an erosion of the equalizing effects of higher education. Policy changes—in higher education and financing, taxation and public assistance, financial aid, and asset accumulation—can reset these respective paths, bringing greater equity and improved educational outcomes, particularly for currently-disadvantaged students.

Reinvest in higher education as a collective good

- To address the factors driving the shift to borrowing, Congress should reverse the declining value of the Pell Grant and reaffirm the commitment to providing financial support for qualified students in need. In the 2010-2011 school year, the maximum Pell Grant award covered only 36% of the average cost of attendance at a public four-year institution, compared to 77% in 1979-1980.[1] While some recent expansions of eligibility for Pell Grants increased the percentage of U.S. families relying on them to some extent, total grants and scholarships only covered 29% of total college costs in 2012.[2]
- State and federal budgetary policy should prioritize human capital investments to rebalance university budgets, particularly in the public institutions that have long been the gateway to educational opportunity. Slowing the rapid increase in the price of college will reduce the gap between what low-income families can save and what they must spend, while helping to bring debt levels down to more manageable levels for those who must borrow.

Minimize the negative effects of student debt

- Shifting financial aid from a debt-ridden proposition to an asset-building one is, quite obviously, not a quick fix. To reduce the negative effects of student debt for today's students, policymakers should explore improvements to communication with students about financial aid and use of different institutional incentives regarding student completion and loan performance; provision of 'emergency' aid, to prevent the disruptions in academic progress often associated with financial setbacks for students heavily leveraged; student incentives for educational attainment, potentially including at least partial loan forgiveness for on-time degree completion for Pell-eligible students; and policies that reduce debt burdens and improve repayment options, including income-based repayment and incentives for employer matching for student debt repayment following graduation.[3]
- U.S. policy needs to intentionally support college graduates as they strive to build assets. Debt does not have to mean that this generation must delay homeownership, net worth accumulation, and other significant milestones towards economic security.
    - Policy should protect graduates' credit scores from student loan effects, as is currently the case for college students, and/or develop home loan products designed to relieve graduates' credit constraints.

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[1] Krugman. (2012, March 12). Building a Caste Society. *The New York Times.* Retrieved from New York Times website: http://krugman.blogs.nytimes.com/2012/03/12/building-a-caste-society/?_r=0

[2] Sallie Mae. (2012). *How America pays for college*. Newark, DE: Sallie Mae. Retrieved from website: https://www.salliemae.com/assets/Core/how-America-pays/HowAmericaPays2012.pdf

[3] Huelsman, M. & Cunningham, A. F. (2013). Making sense of the system: Financial aid reform for the 21st century student. Washington, DC: Institute for Higher Education Policy. Retrieved at IHEP website: http://www.ihep.org/assets/files/publications/m-r/reimagining-aid-design-and-delivery-final-january-2013.pdf

- Directing the financial services industry to aggressively extend savings opportunities to Americans—particularly those economically vulnerable—would help to ensure that, even if student debt continues to grow, liabilities are offset to some extent by growing asset bases. Toward this end, U.S. policymakers should leverage evolving understanding about savings incentives to bring all Americans into structures for positive balance building, including prize-linked savings, prepaid savings cards, expansion of direct deposit, promotion of nontraditional savings outlets, and automatic savings devices.[4]

Eliminate disincentives for college savings

- While policy institutions subsidize asset accumulation of those earning enough to have tax liabilities, current safety net policies serve as disincentives to asset accumulation in low-income households. These rules affect students' educational achievement—means-tested programs with strict asset limits, such as SNAP, reduce the odds that a child enrolls in college.[5] And, by making it nearly impossible for families to save for college, asset restrictions serve to funnel students into the student loan market.
    - Importantly, research suggests that increasing asset limits results in low-income families accumulating assets.[6] These outcomes have spurred innovations, with 37 states eliminating asset limits entirely from SNAP eligibility determinations, and 23 states eliminating asset limits for family Medicaid. Still others have specifically exempted assets most likely to support children's educational outcomes, including 529 plans.
- Currently, financial aid eligibility determinations judge more harshly those assets held in students' own names, despite evidence to suggest that it is precisely these dedicated school assets that have the most significant effects on educational outcomes.[7] To reduce these disincentives for students' savings, eligibility for means-tested grants and loans could be based solely on income, or assets held in special education accounts could be treated differently than overall net worth.
    - As of 2010, 17 states exempted college savings held in 529 plans from financial aid determinations, but these same protections are not afforded in the federal financial aid system, or to students whose savings are held in other vehicles.[8]

Reimagine financial aid as 'early commitment' programs

Today, while much debate over financial aid has centered on questions of amount and type of assistance, the variable of timing, particularly important for improving educational outcomes by influencing student expectations and academic behavior, has been largely ignored.

- The Pell Grant program could incorporate a savings component, rather than issuing awards only at the time of college enrollment.[9] Children could be informed of their expected award earlier in their academic careers; eligibility determinations could be made based on a few years of the household's income, instead of just that senior year; money could be set aside for students in a vehicle that could also accommodate additional deposits by families.

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[4] Boshara, R. (2012). *From Asset Building to Balance Sheets: A Reflection on the First and Next 20 Years of Federal Assets Policy* (CSD Perspective 12-24). St. Louis, MO: Washington University, Center for Social Development. Retrieved at Washington University website: http://csd.wustl.edu/Publications/Documents/P12-24.pdf

[5] Elliott, W. (2013). The effects of economic instability on children's educational outcomes. *Children and Youth Services Review, 35*(3), p. 461-471.

[6] Nam, Y. (2008). Welfare reform and asset accumulation: Asset limit changes, financial assets and vehicle ownership. *Social Science Quarterly, 89*(1), 135-154.

[7] Elliott, W., & Beverly, S. (2011). Staying on course: The effects of savings and assets on the college progress of young adults. *American Journal of Education, 117*(3), 343-374.

[8] Clancy, M., Lasser, T., & Taake, K. (2010). *Saving for college: A policy primer*. St. Louis, MO: Washington University, Center for Social Development. Retrieved from Washington University website: http://csd.wustl.edu/Publications/Documents/PB10-27.pdf

[9] College Board. (2013). *Rethinking Pell grants*. New York: College Board. Retrieved at College Board website: http://media.collegeboard.com/digitalServices/pdf/advocacy/policycenter/advocacy-rethinking-pell-grants-report.pdf

- Universities could divert some of their scholarship money to savings structures, as could states. Localities like San Francisco, CA and Cuyahoga County, OH are essentially taking this approach, investing money not simply in promoting educational attainment of their students broadly, but specifically as deposits for very young children.

Build progressive, lifelong, universal, asset-building child savings structure

- Low-income households that do save for college save a higher percentage of their incomes than wealthy families, and yet they seldom manage to accumulate enough assets to stave off significant student debt. Saving families earning less than $35,000/year have saved only $2000 in median college savings.[10]
- To make Child Savings Accounts (CSAs) work for low-income households, some policy features are essential: automatic enrollment (opt-out), ideally at birth; initial deposits that give all children an immediate stake in their futures; program features to ease access, like low initial deposit requirements; concerted outreach and education; and special incentives, such as refundable tax credits and/or direct matches.
    - Establishing accounts in children's own names would serve the dual purpose of facilitating use over an extended time horizon and for flexible purposes beginning with education and extending to homeownership and retirement, as well as reinforcing the higher education goal in children for whom this is the primary asset need (Elliott, 2013).
    - Accounts students can access while in school may increase their ability to overcome financial obstacles while building their competence in financial decision-making,[11] a critical competency for long-term financial security. Tiered account structures (with short-term, intermediate, and long-term college accounts) would allow low-income children to access to some of their assets as they progress in school, while others are held in reserve. While restrictions on asset use are important facilitators of savings, CSAs can never adequately reduce disparity if accounts are not available for children to use to their educational advantage, just as wealthier students use family resources.
- Significant educational outcome effects are possible even at very low levels of savings. However, low-in[12]come students and families can only be expected to accumulate enough assets to prevent high-dollar college debt if CSAs have adequate assistance to facilitate equity in savings amounts. CSA policy should focus on creating advantages for lower-income households to accumulate assets to compensate for their difficulty saving and the regressivity of tax policies.
    - Families' contributions should be matched through direct transfer into the account or a refundable tax credit. These matches must be significant enough for CSAs to serve as real tools to narrow wealth gaps[13] and adequate repositories of money with which to pay for college.

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[10] Sallie Mae. (2009). How America Saves. Retrieved from website: Retrieved from website: https://www.salliemae.com/assets/Core/how-America-saves/GCR2123HowAmericaSavesforCollege2009Report.pdf

[11] Elliott, W. (2012). *Ideas for refining children's savings account proposals*. (Creating a Financial Stake in College, Report IV). Washington, DC: New America Foundation; St. Louis, MO: Washington University, Center for Social Development.

[12] Boshara, R. (2003). American stakeholder account (Issue Brief). Washington, DC: New America Foundation. Retrieved at New America Foundation website: http://www.newamerica.net/files/nafmigration/archive/Pub_File_1292_1.pdf

[13] Loke, V., & Sherraden, M. (2009). Building assets from birth: A global comparison of child development account policies. *International Journal of Social Welfare, 18*(2), 119-129.

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