In 2015-2016, the federal government handed out $30 billion in need-based grants to students. The majority of that money (just over $28 billion) came in the form of Pell Grants, a program created in 1972 and designed to help low-income students pay for college. Another $925 million came in the form of Federal Supplementary Education Opportunity Grants (FSEOG), a program through which campuses award grants directly to the neediest students (what’s known as “campus-based aid”).

To be eligible for either need-based grant, a student must fill out the Free Application for Federal Student Aid (FAFSA) to demonstrate financial need. The FAFSA collects detailed information on a family’s (or independent student’s) income, assets, family size, and other characteristics to measure how much they are able to contribute, according to federal formulas, to the price of attendance. The resulting number, known as the “expected family contribution” (EFC), is subtracted from the cost of attendance to determine the amount of need-based aid the student is eligible for. Students are eligible to receive the difference between their EFC and the cost of attendance so long as that amount does not exceed the maximum Pell Grant (the “scheduled award”). The scheduled award is then adjusted based on the number of credits they enroll in (the “annual award”). Students from the poorest families, who have an EFC of zero, receive the maximum scheduled award ($5,815 in 2016-2017); the amount of grant aid decreases as the EFC rises until EFC reaches 90% of the maximum grant.

The Department of Education then shares the student’s financial information (from the FAFSA) with any institution that the student authorizes to receive it (as well as state aid agencies in the students’ home state). Institutions can then use this financial information to tailor scholarships and tuition discounts based on students’ ability to pay (known...
as price discrimination). Pell Grants and institutional aid (scholarships and tuition discounts) reduce the price of attendance such that nearly all low-income students (and many middle and upper-income students) pay a “net price” that is substantially lower than the “sticker” or “published price.”

However, despite significant increases in the size of the maximum Pell Grant and the number of Pell recipients, continued increases in tuition have eroded the grant’s purchasing power. Some recent evidence suggests that Pell Grants may have a perverse impact on tuition prices; one study found that institutions reduce institutional aid for students who receive Pell Grants, effectively supplanting rather than supplementing the federal grant aid.

The Pell Grant acts as a portable voucher; students can take it with them to any accredited college to pay for a degree or certificate program. If the grant amount is greater than the cost of tuition, the student can spend the remainder on other qualified expenses (room and board, books, transportation, and so on). The money is disbursed to the campus on a semester-by-semester basis, and students must fill out a new FAFSA each year (the form is now available October 1) if they plan to re-enroll the following year.

Research indicates that need-based grants like Pell encourage low-income students to enroll in college. Collectively, studies of financial aid suggest that an additional $1,000 in grant aid boosts college enrollment by around 4 percentage points. However, the effect of Pell Grants on persistence and completion is less clear. Some studies show that incentive-based grants — where students receive additional grant aid conditional on achieving academic benchmarks — have positive effects on academic outcomes. Studies of pure grants (without academic benchmarks) show mixed effects on degree completion. Experimental or quasi-experimental studies of grant programs in Wisconsin and Florida found that additional grant aid (beyond the Pell Grant) increased persistence and completion rates by a sizable margin. However, a study of the Gates Millennium Scholarship program found no evidence that scholarship money increased persistence or completion compared to those who did not receive a scholarship.

**NEED-BASED AID AND ELIGIBILITY**

Federal grants are sums of “gift aid” given to students through a number of different programs administered by the U.S. Department of
Education. Unlike loans, grants do not have to be repaid. Federal grants tend to be reserved for the neediest students or for students who fall into specific categories; federal grants are not “merit based.”

There are two main federal grant programs: Pell Grants and Supplemental Educational Opportunity Grants (FSEOG). Pell Grants are provided to undergraduate students who have not yet earned a bachelor’s degree and have financial need. The amount a student receives is based on financial need, taking into account the student’s family income, cost of attendance, and enrollment intensity (full-time or part-time enrollment). Students can receive Pell Grants for no more than 12 semesters or the equivalent. Students are guaranteed the full amount that they qualify for, and institutions receive as much aid for their students as they require. In other words, the amount of aid that a student receives is not dependent on the availability of funds at that student’s institution.

For the 2016-2017 award year, the maximum award amount is $5,815. In 2016, the Department of Education provided $28.3 million worth of Pell Grants to 7.7 million students. The average grant amount was $3,683.¹⁰

The FSEOG program is “campus-based,” meaning it is administered directly through the financial-aid office at each participating school. Students receive between $100 and $4,000 per year, depending on their financial need and the amount of other aid they have received. Unlike Pell, the amount of FSEOG money a given student receives depends on the availability of FSEOG funds at the institution or program in which he or she is enrolled. As a result, students who apply for federal aid late in the process are placed at a disadvantage. In 2016, the Department of Education provided $925 million worth of Supplemental Educational Opportunity Grants to 1.5 million students. The average grant amount was $598.¹¹

To apply for any federal need-based aid, students must submit a FAFSA, the 108-question application that the Department of Education uses to determine how much aid, if any, a student is eligible for. The information provided on the FAFSA is used to determine the amount that a family or individual student is expected to contribute to the price of attending a post-secondary institution (this amount is known as the EFC), as well as the amount of grants, work-study, and loans that a student is eligible to receive.¹²

The Department of Education is responsible for determining a student’s EFC based on the questions on the FAFSA. The EFC is calculated according to a formula established by law. The most important
considerations in the formula are a family’s taxed and untaxed income, assets, and benefits, as well as the size of the family and number of family members who will attend college during the year. However, the current FAFSA contains 108 questions, going far beyond this basic information.

The Department of Education has three regular formulas for calculating a student’s EFC: one for dependent students, one for independent students without dependents other than a spouse, and one for independent students with dependents other than a spouse. Each formula also has a simplified version that ignores assets.¹³

Dependent students qualify for the simplified version if their parents have an adjusted gross income (AGI) of less than $50,000 and they fulfill at least one of four conditions: every family member was eligible to file an IRS form 1040A or 1040EZ; their parents were not required to file a tax return; one of their parents is a dislocated worker; or their parents received benefits from a qualifying means-tested program. (The criteria are the same for independent students, though they reflect spousal income and circumstances if the student is married). Additionally, certain students are automatically eligible for a zero EFC: Dependent students (or independent students and their spouses) who qualify for the simplified needs test and have an AGI of $25,000 or less receive an automatic zero EFC.

Students’ FAFSA information is shared with the colleges and career schools that they list on their application. The financial-aid office at the given school then uses the information to determine federal aid eligibility by subtracting a student’s EFC from their cost of attendance. The cost of attendance is different for each school or program, and takes into account tuition and fees, room and board, and books, supplies, and transportation.

Though the FAFSA was created to determine eligibility for federal student aid programs, many individual states and colleges use the information from the FAFSA to distribute state and institutional scholarships. Some private financial-aid providers rely on the FAFSA to determine which students qualify for their aid.

**Problems of Design and Execution**

While such financial aid currently helps millions of families pay for college, there are a number of problems in how federal need-based aid is designed and disbursed. The FAFSA and the Pell Grant program are both plagued with inefficiencies and poor incentives.
To start, the FAFSA is unnecessarily long and complicated. At 108 questions, the form is longer than the IRS 1040 form (79 questions), the 1040A form (51 questions), and the 1040EZ form (14 questions).¹⁴ Officially, the Department of Education asserts that it takes 90 minutes to read the instructions, gather needed materials, and complete the form, but researchers peg the actual time commitment as closer to 10 hours.¹⁵ Estimates from the 2011-12 National Postsecondary Student Aid Study suggest that roughly two million aid-eligible students fail to file a FAFSA each year, 1.3 million of whom would have qualified for a full Pell Grant.¹⁶ Research has also shown that dozens of questions on the FAFSA have almost no impact on the determination of grant aid.¹⁷ In fact, there are currently 30 questions on the form answered by less than 1% of applicants.¹⁸ Calls for simplifying the form have become commonplace in Congress.

The timing of the FAFSA, too, is not optimal. Recent changes that allow students to use tax information from the “prior-prior year” have improved the timing. With that change, students who wish to receive aid in fall of 2017 can use tax information from 2015 (as opposed to 2016). That will allow students to apply for aid in October of the year before enrolling in college, providing far more time to analyze options after learning about aid eligibility. Still, traditional-age students do not learn about the amount of aid for which they are eligible until their senior year of high school, which is too late to influence the course-taking, study habits, and financial planning that are often prerequisites to college attendance. Thanks to this delay, many students either do not believe college is an attainable goal or that they must attend an institution with a low sticker price, and they make choices based on this belief.¹⁹ Many of these choices, made solely or in part because students believe college to be financially out of reach, dampen college attainment.

The FAFSA also gives colleges an informational advantage. Schools use the detailed financial information from the FAFSA to price discriminate, charging different students different prices. For instance, a school knows a good deal about a student’s willingness to pay, including the amount of federal grants and loans a given student might be eligible for. This puts colleges at an advantage vis-à-vis students and families, and enables some of them to substitute institutional aid away from students who receive federal grants.²⁰

The Pell Grant program is also flawed. First, it is not sufficiently flexible. Students can only receive two semesters’ worth of Pell Grants in a
given academic year. That prevents students who enroll full-time from using Pell money year-round. For instance, a student who takes a full course load in the fall and spring semesters will not be eligible for any Pell Grant money in the summer, even though completing additional credits will help them finish more quickly. In addition, because financial-aid eligibility is rigidly determined each year, students do not have a sense of how much grant money they have to work with to finance their entire college career.

Second, the Pell Grant could do more to incentivize timely completion. Under current federal rules, students are considered “full-time” for the purposes of their Pell Grant award if they enroll in 12 credits. But students cannot finish a two- or four-year degree in normal time taking 24 credits a year (60 and 120 credits, respectively, require 30 credits a year). As such, various reform proposals have called for increasing the definition of full-time to 15 credits, perhaps providing students who take 15 credits with a larger award.

A REFORM AGENDA

Given the current state of affairs, the time is ripe for reform. Potential policy solutions range from moderate changes that leave most of the existing structure intact, to a set of bolder ideas that would constitute more dramatic changes.

An area of bipartisan agreement is a good place to start, and policymakers, advocates, and researchers on both sides of the aisle have called for simplifying or eliminating the FAFSA. Proposals range from dramatically reducing the number of questions and simplifying the needs analysis to eliminating the FAFSA entirely and relying on tax data from the IRS to conduct the needs analysis (see below for more on that approach).

Evidence suggests that the tradeoffs between simplicity and targeting are small: The majority of questions on the FAFSA have little marginal impact on aid eligibility. Just a small handful of questions on the current FAFSA—most notably household income and family size—account for about 80% of the variation in Pell Grant eligibility. Susan Dynarski and Judith Scott-Clayton estimate that using only parents’ adjusted gross income (AGI) would capture 75% of the variation in Pell Grant eligibility. Adding assets and family structure to the analysis explained 90% of the variation.21
The most prominent simplification effort is the FAST Act, introduced by Senators Lamar Alexander (R-TN) and Michael Bennet (D-CO), which would trim the FAFSA application to a two-question postcard: AGI and family size. Income information and family size (the number of exemptions) for relevant past years could be retrieved directly from the IRS, and students whose parents receive any means-tested federal benefits would automatically be eligible for a grant. A simple look-up table would allow families to learn their likely grant amount before senior year of high school.

Note that shifting to a two-question FAFSA would entail a significant change to the needs analysis, which would have consequences for targeting. Institutions have also warned that reducing the amount of information they have on a family’s income situation would force them to require supplementary forms in order to target institutional aid as they do now.

Another, more moderate reform would sort individuals based on the complexity of their tax return and require those who file additional schedules to provide asset information. For less complex filers, aid eligibility could be determined by just using AGI and family size.

A moderate agenda should also include reforms to determining aid eligibility, making certain to target resources to the neediest students. Students are eligible for a Pell Grant until their EFC equals 90% of the maximum grant. Each time the maximum grant increases, therefore, more middle-income students become eligible for a small Pell Grant. One analyst found that 5% of Pell Grant recipients had incomes greater than 250% of the poverty line.

Policymakers could target aid more effectively by simply capping eligibility. One proposal from the College Board calls for using the poverty line, which is indexed to inflation. Subsequent increases in Pell funding would then be more effectively targeted to the neediest students.

Another moderate reform that could make a big difference is enabling students to get notification about potential aid eligibility earlier. The Obama administration’s use of existing legislative authority to move to “prior-prior year” income information is a significant change that empowers students and families. But there is room to notify students even earlier. Providing information about potential federal financial-aid opportunities to students early on—and making the academic and behavioral expectations clear—could encourage more of...
them to prepare for college.²⁷ A couple of field experiments have found that informing middle- and high-school students about the financial aid they will likely be eligible for, the returns to education beyond high school, and the net price of college can boost aspirations and encourage students to spend more time studying.²⁸ Promise programs, through which any student in a particular geographic area who graduates from high school is eligible for free tuition paid by a local government, are widely recognized by students in covered locations and also appear to have a similar effect on student behavior and aspirations.²⁹

What can the federal government do on early notification? Financial-aid researchers have proposed using data from federal tax returns to notify families about their child’s likely eligibility for financial aid.³⁰ A letter could function like an annual Social Security statement and would tell families how much aid their child would receive under current policy if they were to enroll in college that year. Sandy Baum and Judith Scott-Clayton suggest starting as early as elementary school, when the IRS could use basic information from a tax return to provide an estimate for purely informational purposes.³¹ Families could opt-in to such a system when filing taxes, and the notification should also spell out the steps their student must take to prepare for college. No grant funding would actually be committed until the student enrolls in college (see below for a more far-reaching proposal).

To increase the incentive to complete course requirements on time, reformers should create a system that awards more Pell Grant money to students who take a full course load. Currently, a student earns the same size Pell Grant whether they enroll in 12 or 15 credits, even though the latter course load enables them to finish on time. As a result, students who take more credits actually get less Pell Grant money per credit than those who take fewer courses. Over the course of their career, the 12-credit student actually gets more Pell money than the 15-credit student. This is perverse.

A better system would peg the amount of Pell Grant money to the number of credits (or units of learning) a student takes.³² Those who enroll in 15 credits would get more than those who enroll in 12, those who enroll in eight would get more than those who enroll in six, and so on. Such a change would provide the most Pell money to students enrolled in a full course load, essentially redefining “full-time” to mean 15 credits.

Marcus Szymanoski, director of regulatory affairs at DeVry Education
Group, has proposed a system (called the Student Aid Modernization Initiative) where students would be awarded the full amount of Pell Grant funds needed to finish their program (four years’ worth of Pell for a bachelor’s degree, for instance), and in any given semester would receive a grant proportional to the number of credits they signed up for. In other words, a student who was eligible for a $5,000 annual Pell award and enrolled in a 120-credit BA program would be awarded $20,000 ($5,000 x 4 years) for the entire program. They would then receive $166 per credit they signed up for. Students would know how much grant money they’d have to spend on their program and would receive an amount proportional to their effort.³³ (Such an approach would also create more flexibility for students to enroll year-round; see below.)

Proposals to move away from the 12-credit, full-time definition raise a budget question. Under a per-credit pro-rated system, should the maximum grant stay the same, and the number of credits needed to receive that grant increase from 12 to 15? Or should the maximum grant increase as well? One estimate from 2013 found that the first approach would lead to savings of $39 billion over 10 years.³⁴ The alternative, which would provide larger grants to those who take 15 credits, would be more costly: that same study showed that if students taking 30 credits a year received a $7,000 maximum grant — a sizable increase — the overall cost would be $86 billion over 10 years. A smaller increment of additional aid would obviously be less costly (the Obama administration proposed an additional $300 Pell Grant bonus in previous budgets, but the idea did not make it into legislation.)³⁵

Of course, the costs of such a proposal should be compared to the potential benefits. Research suggests that incentive-based grants, where students receive additional grant aid if they meet academic benchmarks, can increase credits attempted, time spent studying, and persistence and completion rates.³⁶ Students who finish a credential on time consume less federal and state aid than those who take longer to graduate. They also enter the labor force sooner, generating additional tax revenue. A demonstration project could test whether a pro-rated model is cost-effective.

Even a modest reform of federal need-based aid should be accompanied by an effort to remove impediments to saving for college. Despite tax incentives to save for college in 529 plans or prepaid-tuition plans, savings rates are low, especially among low and middle-income families.³⁷ Policymakers should take steps to eliminate any disincentives that
the federal needs analysis creates when it comes to college savings.³⁸ The needs analysis currently treats savings accounts owned by parents or students themselves as assets, meaning aid eligibility is reduced proportional to the net value of the asset. For 529 accounts owned by parents, the penalty toward aid eligibility is a maximum of 5.64% of net assets; when independent students own the asset, the penalty is much higher (20%). When the savings account is owned by a different relative (a grandparent, aunt, or other relation), qualified disbursements are treated as taxable income to the student, and the student’s aid eligibility can be reduced by as much as 50% the following year.³⁹ Savings in prepaid-tuition plans reduce aid on a dollar-for-dollar basis.⁴⁰

In short, there is a savings penalty built into the federal needs analysis, and that penalty applies to lower and lower-middle income families who are eligible for need-based aid. As a 2004 study remarked, “though high-income families have no disincentive to save for college, lower income families do: By saving — and especially by choosing the ‘wrong’ savings instrument — they can reduce their eligibility for need-based aid.”⁴¹

Reforms should focus on eliminating disincentives to save and encouraging incentives to do so. Policymakers should revise the needs analysis to leave college-savings accounts (and disbursements from them) out of the needs analysis for individuals below a particular income threshold. They should also change the tax treatment of employer matches to college-savings plans, which, unlike 401k contributions, are currently treated as taxable income. The current tax implications may dissuade some from saving (and some employers from offering the benefit).⁴²

NEED ANALYSIS AND YEAR-ROUND PELL

Our federal system of need-based financial aid would be simplified and advanced by the reforms suggested above, but there is room for improvement. Efforts to simplify the FAFSA, for instance, are subject to two criticisms. First, efforts to simplify decrease the amount of information that the feds have to judge need, raising the probability that some people might receive aid who do not actually need it. Second, even if policymakers are able to delete some items this year, there is always a chance that complexity creeps back in as policymakers work to target aid more effectively.

Under a more aggressive plan, the problems with the FAFSA would be handled by removing the form from the equation. Some reformers
have called for eliminating FAFSA entirely and instead determining aid eligibility directly via the tax returns that individuals submit to the IRS. The majority of the information needed to determine aid is available on IRS form 1040. In a simulation, Susan Dynarski and Mark Wiederspan found that throwing out all of the data used on the FAFSA except for items available on IRS form 1040 explained 89.6% of the variation in Pell Grant eligibility. Their simulated grant is within $100 of the baseline Pell Grant for 78% of all students, and within $500 for 88% of all students.⁴³

There are two basic options for moving forward without the FAFSA. Dynarski and Judith Scott-Clayton propose a system whereby families could check off a box on their 1040 form to signal that one or more of their children is interested in attending college. The IRS could then pass on the relevant information on income, family size, and additional schedules filed to the Department of Education, where aid administrators could determine eligibility using a revised needs analysis that relies only on information contained on form 1040.⁴⁴

Alternatively, policymakers could use the IRS form 4506-T, which individual taxpayers can use to authorize the IRS to provide a copy of their tax transcript to a third party. In this case, the Department of Education could create a simple application whereby parents and students provide basic information (name, address, Social Security number) and grant authorization to the IRS to report their tax transcript to the Department of Education.⁴⁵ The department could then put the information on the tax transcript through a revised needs analysis. Families that do not file taxes could submit the same form to obtain a “Verification of Non-filing” from the IRS. Those who file additional tax schedules could be required to provide asset information. Note that the IRS form 4506-T allows taxpayers to request up to four years’ worth of tax information, perhaps enabling a shift to a needs analysis that looks at multiple years of income instead of just the most recent.⁴⁶

Critics argue that simplification efforts could hurt states’ and colleges’ ability to target their aid to needy students. The Department of Education could therefore share some basic information on a students’ ability to pay with the parties that currently have access to FAFSA information.⁴⁷ The use of tax transcripts would also reduce the burden placed on institutions to verify students’ eligibility for financial aid.

Reforms should also reinstate the year-round Pell Grant program, which allows students to accelerate their progress toward a degree by
awarding a second grant to those who take more than a year’s worth of credit in one year. This program was proposed by the George W. Bush administration and Republicans in Congress before being passed in the 2008 reauthorization of the Higher Education Act. It was eliminated in 2011, ostensibly due to higher-than-expected costs and a lack of evidence for its effectiveness. In reality, as Jason Delisle and Ben Miller have argued, it appears that policymakers sacrificed year-round Pell in order to maintain the size of the maximum grant.⁴⁹ Recently, the Senate Appropriations Committee approved a funding bill for FY2017 that would restore the year-round Pell Grant program; however, it was voted down by the House of Representatives Appropriations Committee and left out of the most recent Congressional spending bill.⁵⁰

A new year-round grant program could be modeled on the 2009–2010 version: Students who attempted to earn more than 30 credits in a given academic year could apply to receive a portion of a second grant to cover the cost of credits earned in a third academic session. For example, students who earned 15 credits in both the fall and the spring could receive a pro-rated portion of a second grant to cover the cost of additional credits earned in the summer. The prior program allowed students who had not completed 30 credits after two semesters, but would surpass 30 credits by enrolling in an additional session, to access a second grant. The total amount awarded in a year could be capped at 150 percent of the students’ scheduled award.

Note, also, that a flexible, per-credit disbursement model (like that described by DeVry’s Szymanoski) would create year-round Pell Grants by default.⁵¹ Students would be able to draw down a portion of the total Pell Grant funding necessary to complete their program in proportion to the number of credits in which they enroll. A student who enrolled year-round would simply receive the per-credit amount of Pell for any courses taken in the summer or during alternative sessions.

AID OVERHAUL

Instead of merely changing or replacing the existing pieces of the need-based aid system, ambitious reformers could reimagine need-based financial aid entirely by eliminating the FAFSA and shifting Pell Grants to a flexible-account model.

Republicans have often proposed shifting social programs to flexible, account-based models that beneficiaries can spend at their
discretion on a number of different services and providers. The Flexible Savings Account (FSA), the Health Savings Account (HSA), and the Individualized Training Account (ITA) are examples. Some leaders have called for shifting the Pell Grant to such a “flex fund” or “education-savings account” model.⁵²

This model could help ameliorate some of the thornier information problems associated with need-based aid: for instance, that students and families do not know how much they might receive until they fill out a complex government form, and even then the amount is only good for one year. Having grant aid in an account that “rolls over” from one year to the next might also encourage more students to seek out lower-cost credits.

How might such an account work? Starting when a child is in eighth grade, the federal government could begin “depositing” need-based Pell Grant funds into a flexible account for the student’s post-secondary education. The aid disbursement would be based on tax returns, thus eliminating the need for the FAFSA entirely. Families could check a box when filing their taxes to indicate that they have a child who is 12 (or older) who is interested in pursuing post-secondary education. Families who do not file taxes could file a form with basic income documentation; those who receive means-tested benefits and whose income falls below a particular threshold would be automatically eligible for the maximum grant amount.

For eligible children whose families checked the box on their tax return, the federal government would set up an account in that child’s name and “deposit” an amount of Pell Grant funds each year as the child approaches high-school graduation. The amount deposited would reflect their family income in the previous year. Prospective students would then know exactly how much grant aid they have to spend when they start college, and could estimate how much they are likely to have long before they reach college age.

The funds would not actually be disbursed until a student graduated high school and received their first tuition bill. Policymakers would likely want to design the Pell account with appropriate spending caps—caps on the amount of money a student can draw down in a given year and for a given program length (i.e., students could draw down half as much for a two-year degree as they could for a four-year degree). At the same time, the account-based model could provide
added flexibility that would allow students to allocate their grant funds as they wish. A note of caution: Policymakers must acknowledge the potential price effects of giving students maximum flexibility to spend this grant money however they wanted.

To balance the desire for flexibility with the need to protect against tuition inflation and waste, policymakers might consider granting students who attend schools with above-average outcomes more flexibility. Under current law, institutions with low student-loan default rates are rewarded with greater flexibility when it comes to disbursing loan dollars.⁵³ The new account-based Pell program could grant greater flexibility to students who enroll in colleges with a track record of success, allowing them to draw down more grant aid per year if they chose to.

This approach has a number of strengths. First, and most obviously, it provides students with information about grant aid much earlier in their schooling career, which could enhance the existing incentives to work hard and take necessary courses. The account-based model would also signal to students how much grant aid they have to spend from the start of their post-secondary career. And because any payments would be debited from said account, students might be more inclined to seek out cost-effective options.

Another strength of this approach is that it provides a more comprehensive picture of a students’ family income than the single year used to determine annual aid amounts now. If access to grant aid is supposed to reflect chronic disadvantage rather than temporary disadvantage, relying on multiple years of income is a better measure than an annual snapshot.⁵⁴ An account-based model that combines a few years’ worth of family income information in determining the total amount of aid available is more effective. Students whose families experienced sudden hardship after enrolling could apply for aid via a simplified FAFSA.

Of course, some students will receive grant aid prior to high-school graduation even though their family incomes increase later. As it turns out, family incomes (and therefore aid eligibility) are quite stable over time. One study simulated the effect of awarding Pell Grants to any eighth grader who receives means-tested benefits to gauge how much such a change might cost. The authors estimated that fewer than one in ten students who would qualify under the new formula would not qualify under current rules, and that the new approach would cost an additional $1.5 billion annually. They also estimate that the benefits of
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early notification (increased educational attainment) would outweigh the costs by about $600 million.⁵⁵

A final strength, already mentioned, is the potential for added flexibility. An account-based model would obviate the need for a special policy around year-round Pell Grants. It might also encourage students to seek out the most cost-effective options for earning credit and obtaining skills (courses at community college that transfer to the four-year campus) so that they could save their grant dollars for the experiences that cost more money. Others might choose to front-load their grant dollars, thereby lowering the risk that they take on debt but not complete their degree.

At the very least, policymakers should consider experimenting with such an approach via a demonstration project that would randomly assign students to the account-based model or the standard year-by-year application and disbursement model.

When combined with the income-share line of credit described in the next section, the account-based Pell would usher in a new federal financial-aid system that would be much simpler, more predictable, and more transparent.
REFORMING NEED-BASED AID

1. The views expressed here are solely those of the author and do not reflect those of his employer.


3. For instance, the College Board estimates that in 2011-2012, grant aid covered the full cost of tuition and fees for 62% of dependent, full-time students from families earning less than $30,000 a year. When room, board, books, and other expenses are included, these students faced an average price of attendance of $12,000. College Board, “Trends in College Pricing 2015,” http://trends.collegeboard.org/sites/default/files/2015-trends-college-pricing-final-508.pdf.


5. David O. Lucca and colleagues at the Federal Reserve Bank of New York found that a dollar increase in the maximum Pell Grant was associated with a sticker price increase of 40 cents, though the effect was sensitive to model specifications. See David O. Lucca, Taylor Nadauld, and Karen Shen, “Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs,” (staff report no. 733, Federal Reserve Bank of New York, October 2016), www.newyorkfed.org/medialibrary/media/research/staff_reports/sr733.pdf; On substituting Pell Grants for institutional aid, see Lesley J. Turner, “The Road to Pell is Paved with Good Intentions: The Economic Incidence of Federal Student Grant Aid” (working paper, University of Maryland, 2014), http://econweb.umd.edu/~turner/Turner_FedAidIncidence.pdf.

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11. Ibid. In addition to the two main programs, the federal government also administers some smaller grants that go to specific categories of students. One is the Teacher Education Assistance for College and Higher Education (TEACH) Grants. The TEACH program provides grants of up to $4,000 each year to students who complete or plan to complete course work needed to begin a career in teaching. Consequently, students who receive these grants are required to take certain types of classes and pursue certain types of degrees to become eligible. As a condition for receiving the grant, students agree to teach in a high-need field at an elementary school, secondary school, or educational-service agency that serves students from low-income families for at least four complete academic years. Students who do not complete their service obligation have their grant converted to a Direct Unsubsidized Loan and must repay the money to the Department of Education, with interest. Eligible students must
be enrolled in a school that participates in the TEACH Grant program and meet certain academic requirements, which generally include scoring above the 75th percentile on one or more portions of a college admissions test and maintaining a cumulative GPA of at least 3.25. In 2016, the Department of Education provided $88.5 million worth of TEACH Grants to 30,717 students. The average grant amount was $2,881. Another federal grant program awards Iraq and Afghanistan Service Grants to students with a parent or guardian who died in Iraq or Afghanistan as a member of the U.S. armed forces. Student must have been under 24 years old or enrolled in college at the time of their parent’s or guardian’s death to be eligible to receive this specific federal grant for college or career school. Iraq and Afghanistan Service Grants are only provided to eligible students who do not qualify for the federal Pell Grant on the basis of their Expected Family Contribution. The grant award is equal to the amount of a maximum federal Pell Grant for the given award year, but cannot exceed a student’s cost of attendance for that award year. For the 2015-2016 award year, the maximum amount is $5,815. In 2016, less than 100 students received an Iraq and Afghanistan Service Grant; the cost of the program totaled $453,000, with an average grant amount of $4,918.


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20. Lesley Turner estimates that selective private nonprofit colleges capture about two-thirds of Pell Grants via substitution. See Turner, “The Road to Pell is Paved with Good Intentions.”


24. 20 U.S. Code § 1070a: “No Federal Pell Grant shall be awarded to a student under this subpart if the amount of that grant for that student as determined under this subsection for any academic year is less than ten percent of the maximum amount of a Federal Pell Grant award determined under paragraph (2)(A) for such academic year.”


29. For instance, see Timothy Bartik, Randall Eberts, and Wei-Jang Huang, The


32. The National Association of Student Financial Aid Administrators (NASFAA) has called for a “Super Pell,” which would provide additional money to students enrolling in 15 credits per semester. See NASFAA, “Reimagining Financial Aid to Improve Student Access and Outcomes,” 2013, www.nasfaa.org/uploads/documents/ektron/67439aeb-419d-4ec9-9c35-4278dcbbed61/d19119911e864c39ab-b555e99f130d122.pdf; Baum and Scott-Clayton (2013) call for a pro-rated Pell where students could earn additional dollars for each credit up to 45 credits in an academic year.


34. HCM Strategists, Doing Better for More Students.


41. Ibid.


43. Dynarski and Wiederspan, “Student Aid Simplification: Looking Back and Looking Ahead.”


46. The Rethinking Student Aid Study Group’s *Fulfilling the Commitment* report called for using three years’ worth of income information in needs analysis.

47. College Board, *Fulfilling the Commitment*.


51. Szymanoski, “Student Aid Modernization Initiative.”

52. Republicans on the House of Representatives’ Education and Workforce Committee called for the creation of a “Flex Pell Grant,” which “would allow a student to learn of the amount of Pell funds he or she is eligible to receive over a six year period and then be able to draw funds as needed until the student either completes his or her academic program or exhausts the allotted funds. This policy would allow an annual adjustment to the student’s awarded funds if his or her economic situation changes from year to year.” See House of Representatives Committee on Education and the Workforce, “Strengthening America’s Higher Education System,” June 2014, http://edworkforce.house.gov/uploadedfiles/hea_whitepaper.pdf. Also Paul Ryan’s 2014 discussion draft “Expanding Opportunity in America,” which called for Pell to be converted to a “flex fund”: “A student’s award over a six-year period would be available for her to spend as needed until her program is completed or her grant is exhausted,” see House Budget Committee, Expanding Opportunity in America, 2014, http://budget.house.gov/uploadedfiles/expanding_opportunity_in_america.pdf. Finally, Governor Jeb Bush’s presidential campaign also called for an account-based Pell model as well, see Andrew Kelly and Jason Delisle, “Jeb Bush’s Plan to Help Students Pay for College,” National Review, January 18, 2016, www.nationalreview.com/article/429921/jeb-bush-higher-education-reform-financing-college-tuition.

53. See 34 CFR § 685.303, “Processing Loan Proceeds,” www.law.cornell.edu/cfr/text/34/685.303: “(6)(i) A school is not required to make more than one disbursement if—(A)(1) The loan period is not more than one semester, one trimester, one quarter, or, for non-term-based schools or schools with non-standard terms, 4 months; and (2)(i) Except as provided in paragraph (d)(6)(i)(A)(2)(ii) of this section, the school has a cohort default rate, calculated under subpart M of 34 CFR part 668 of less than 10 percent for each of the three most recent fiscal years for which data are available; (ii) For loan disbursements made on or after October
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1. 2011, the school in which the student is enrolled has a cohort default rate, calculated under either subpart M or subpart N of 34 CFR part 668, of less than 15 percent for each of the three most recent fiscal years for which data are available.

54. The College Board’s Rethinking Student Aid Study Group’s report called for using three years’ worth of income information in needs analysis. See College Board, Fulfilling the Commitment.


Reforming Student Loans and Tax Credits


