The Committee for Economic Development

A New Partnership:

Reshaping the Federal and State Commitment to Need-Based Aid

Written by William R. Doyle, January 2013

Executive Summary

Key Issues Facing Student Financial Aid System

College Prices:

College prices continue to increase faster than prices in nearly any other part of American society.

Pell Grants:

Despite generous increases in funding the Pell Grant cannot keep pace with the increases in college prices.

Other Non-Loan Aid:

Beyond the Pell Grant program there are three other major sources of non-loan financial aid—state financial aid, institutional financial aid, and tax credits for postsecondary education. All of these programs spend lots of money on students who would go to college without further assistance.

Applying for Aid:

Applying for federal aid is unnecessarily burdensome and involves duplication of effort among individuals and government agencies.

Federal Loans:

Federal loans to students have increased rapidly, both in total amount borrowed and in per-person borrowing. Default rates on federal loans have also risen.

Principles for Reform

- The purpose of federal financial aid is to ensure that individuals who can benefit from college and would not otherwise attend are able to enroll.
- Efforts to reform financial aid must limit the unsustainable increase in college prices.
- Financial aid at all levels–institutional, state and federal— should be focused on those students who would not go to college without additional funding. This is the most efficient use of scarce resources.
- The federal financial aid system should ensure access to higher education, not reward academic success or attempt to steer students into certain sectors of the labor market.
- Simplification of the process for application for financial aid and the process of repaying loans should be encouraged for the purposes of increased student access and more efficient use of resources.

A Redesigned Federal System of Financial Aid

1. Combine all current federal grant programs into one federal-state matching grant program. Matching funds will be awarded to states on the basis of several criteria, with the primary requirement being that the state must match federal spending at a rate of one state dollar for every four federal dollars. For states to be eligible, grant funding from this program must be given on the basis of need, and tuition increases at public institutions of higher education must be limited to the rate of increase in family income.
2. Eliminate tax credits for higher education, which primarily provide funding for students who would attend college anyway.
3. Use the savings from the elimination of the tax credit program to fund a "Race to the Top" for state-level efforts to improve access through student financial aid based on known best practices, and a competitive campus-based incentive program that rewards campuses for funding need-based aid that encourages student success.
4. Simplify the financial aid application process by having student aid eligibility determined using tax returns.
5. Make income-based repayment the "default" option for loan programs, with repayment handled through a payroll withholdings approach similar to federal insurance contributions.

Intended Outcomes of the Reforms:

- More low-income students and families would pay less for college, increasing college attendance in many states by as much as 9%.
- All students would understand aid eligibility more clearly and sooner.
- All students and their families would see affordability increase as the college price spiral slows.
- Students would benefit from innovative new programs designed to improve both access and success at the state and campus level.
- Students would benefit from greater clarity and ease in repaying student loans, default would be largely eliminated.
- States and institutions would be encouraged to pursue greater efficiency in delivery of higher education to more students.