NEW AMERICA

EDUCATION POLICY

HIGHER EDUCATION

STARTING FROM SCRATCH

A New Federal and State Partnership in Higher Education

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About New America

New America is committed to renewing American politics, prosperity, and purpose in the Digital Age. We generate big ideas, bridge the gap between technology and policy, and curate broad public conversation. We combine the best of a policy research institute, technology laboratory, public forum, media platform, and a venture capital fund for ideas. We are a distinctive community of thinkers, writers, researchers, technologists, and community activists who believe deeply in the possibility of American renewal.

Find out more at **newamerica.org/our-story**.

About the Education Policy Program

The New America Foundation's Education Policy Program uses original research and policy analysis to solve the nation's critical education problems, serving as a trusted source of objective analysis and innovative ideas for policymakers, educators, and the public at large. We combine a steadfast concern for low-income and historically disadvantaged people with a belief that better information about education can vastly improve both the policies that govern educational institutions and the quality of learning itself. Our work encompasses the full range of educational opportunities, from early learning to primary and secondary education, college, and the workforce. We are deeply engaged in ongoing developments in educational technology at all levels of child and adult development. We believe new organizational models have potential to achieve breakthrough levels of performance on behalf of students. And we believe that all providers of education must be held constructively accountable for the quality of their work.

Our work is made possible through generous grants from the Alliance for Early Success; the Annie E. Casey Foundation; the Bill and Melinda Gates Foundation; the David and Lucile Packard Foundation; Evelyn & Walter Haas, Jr. Fund; the Foundation for Child Development; The Heising-Simons Foundation; the Joyce Foundation; the Kresge Foundation; the Lumina Foundation; the Pritzker Children's Initiative; the William and Flora Hewlett Foundation; the W. Clement and Jessie V. Stone Foundation; and the W. K. Kellogg Foundation.

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INTRODUCTION

Every year, millions of young people sit down with their parents to fill out a daunting form called the "FAFSA" – the Free Application for Federal Student Aid. After assembling bank statements, old tax returns, and W-2 forms, they painstakingly fill in a series of boxes in order to discover how much the federal government expects them to pay for college. This expected family contribution, or EFC, is a kind of official judgment of shared responsibility, a statement of how much families can afford to contribute toward the education their children need to have a fighting chance in the cutthroat modern economy.

Then, a few weeks or months later, many of those same families get a letter from the college in the mail informing them that the actual amount of money they need to pay for that college is much more.

The difference can be hard to spot, sometimes. Colleges like to hide the number inside a financial aid "package." Packages are, as a rule, things that people like to open, like holiday gifts. But for a growing number of students, college aid packages contain financial time bombs, in the form of large student loans. Students, and increasingly parents, are expected to borrow thousands or tens of thousands of dollars in order to finance school. It does not matter whether the college is good or bad, or whether the student actually earns a degree. The debts remain.

While student loan burdens affect people across the economic spectrum, low-income families suffer the most. The aggregate default rate in the federal student loan portfolio has reached an all-time high, and first-generation and impoverished students are the most vulnerable to fraud, indebtedness, and failure. Almost *90 percent* of families earning less than $30,000 per year are required to pay more for college than their official expected contribution, compared with only 37 percent of families making more than $110,000 (see Figure 1). For too many vulnerable families, paying for college has become a precarious obstacle to financial stability, rather than the pathway to opportunity used by past generations of students to move ahead.

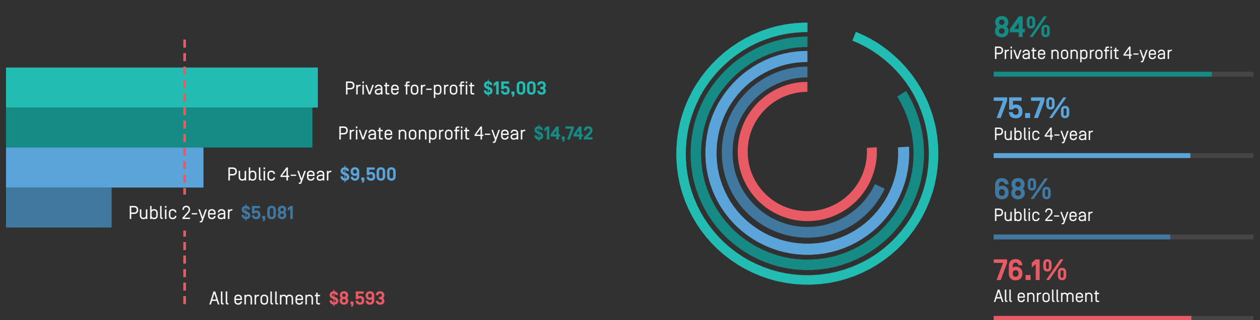
In recent months, a number of high-profile plans have been promoted pledging to restore the promise of free or debt-free college, including proposals from leading presidential candidates. They included many important and worthy ideas. But they are all, in different ways, built atop the foundation of the existing system of higher education, the basic financial and regulatory bargain between the federal government, states, and institutions that has existed for more than 40 years.

That foundation is irreparably broken. It has been stressed beyond the breaking point by misaligned incentives, unaccountable lawmakers, and industry changes that the original builders could never have foreseen. Any reforms that keep the underlying system in place are doomed to fail, and thus to perpetuate the cycle of indebtedness that is engulfing a generation of students and families.

This New America white paper proposes a new relationship between the states and the federal government. These reforms will create powerful incentives for state governments to end the financial disinvestment that has been steadily hollowing out America's great public university and community college systems. They will hold all colleges–public, private, and for-profit– equally accountable for enrolling low-income students and giving them a good education at an affordable price. And they will ensure that every single college student in America will only have to pay his or her expected contribution for college, halting the spread of indebtedness once and for all.

Figure 1: Median Unmet Need for Students, in 2015 Dollars

By Institution Sector



By Family or Student Income

Source: New America's analysis of U.S. Department of Education National Postsecondary Student Aid Study, 2012.

THE EXISTING SYSTEM

The federal student aid system was designed in a different era. In the late 1960s and early 1970s, private college tuition was often affordable and undergraduate borrowing was kept at a minimum. Public colleges and universities, which were well funded by their states, generally provided a low-cost higher education to resident students. The Pell Grant program created in 1972 has helped millions of low-income students pursue a higher education.

As the bedrock of the modern student financial aid system, the Pell Grant—a voucher where low-income students could use federal dollars to pay to attend virtually any college in the country—was designed to increase access to college for the neediest students and develop a more educated workforce. Prior to this program, most government money invested in higher education went directly to the schools, whereas these dollars flowed to the individual.

But over the years, the system has broken down. Starting in the early 1980s, colleges and universities began consistently increasing prices, continuing unabated today. Despite large increases in appropriations, the Pell Grant program has not been able to keep up with these ever-rising prices. At the same time, states that oppose tax hikes and face rising health care and public safety costs, have been cutting funding from their public higher education systems, particularly during economic downturns. Meanwhile, many colleges, in their never-ending pursuit of prestige and revenue, have spent more and more of their own institutional aid dollars on wealthy students who help them raise their rankings and bolster their bottom lines.

As a result, low-income students have had to take on greater and greater amounts of debt. This has been an extremely risky proposition for students who graduate from college at a much lower rate than their wealthier peers. Many low-income dropouts end up defaulting on their loans (there are currently 7 million borrowers in default).[1] For these students, going to college has left them in a much worse position than if they had never enrolled.

Many of the problems the student aid system has experienced are a result of its faulty design.

The current aid system is a combination of vouchers, loans, and tax credits, all of which follow the student. The system has failed to assure that institutions receiving aid give their students a quality education for an affordable price.

The Pell Grant program, for example, has two major flaws. First, it penalizes schools that charge low tuition. The maximum Pell Grant award for the 2015-2016 academic year is $5,775.[2] If, for example, a school charges in-state students $2,000 in tuition, the students can use their remaining Pell Grant dollars for food, housing, and books. A school charging $6,000, by contrast, retains the entire Pell Grant for itself, while the student is left with no remaining dollars for cost-of-living expenses and still owes some tuition out-of-pocket. This is the opposite of what ought to happen. Schools that keep tuition affordable for low-income students should be rewarded with *more* funding, not less.

Second, schools participating in the federal aid program are not held accountable in a meaningful way by the federal government for the quality of the education they provide. The worst colleges—and some are terrible in terms of student outcomes—get the same amount of revenue per student as the best. And because the Pell voucher can be used no matter how much a school charges, it can be a gateway to an even more pernicious aspect of the current federal student aid program: loans.

Like the Pell Grant program, the federal student loan program was created with good intentions. Individuals reap private benefits from higher education in the form of increased lifetime wages. Taking out a small loan to finance long-term gains is a solid investment. Furthermore, undergraduate financing is a classic example of private market failure: Because 18-year-olds have no credit or collateral, private companies are unlikely to lend money to them. This is despite the fact that, with a degree, these students are likely to increase their lifetime earnings and will be able to pay back the loan.

But the federal student loan program has gone awry. The government lends money to any student going to any accredited college, even if the school has a proven track record of high defaults, low completion rates, and no marginal increase in earnings for the students attending.

And like the Pell program, the student loan program rewards schools that charge higher tuition, except this time the student has to pay the money back and many struggle to do so. Of borrowers who attended a two-year school, dropped out or graduated, and began paying their loans back in 2012, 64 percent had *more* aggregate student loan debt two years later compared to when they started repaying.[3] In 2002, only 37 percent of students in the same circumstances had rising loan balances two years later.[4] Interest is compounding as many graduates fail to make payments on their debts. Even those who do not default outright on their debts may be struggling. Of borrowers in the federal student loan portfolio who should be making monthly payments, at least 40 percent are not current on their loans.[5]

Worse still, a different federal program offers unlimited loans to the *parents* of college students, with minimal underwriting standards. This program is particularly troubling since institutions can leave low-income parents with loans they may never be able to pay back, starting a cycle of intergenerational debt for precisely the students who need the most financial resources to get through school.

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The third major form of aid is the tuition tax credit system, which was added to the current system in the late 1990s. These credits disproportionately benefit wealthier families, as well as private and for-profit colleges, which typically charge higher tuition.[6]

In other words, all three major components of the current federal financial aid system reward schools that charge students and families more while penalizing schools that charge less.

By creating the voucher and tax credit system, the federal government also unintentionally created incentives for states to disinvest in their affordable public institutions. As states have examined their limited budgets (and grapple with funding mandates for Medicaid and state pensions), they have increasingly seen federal dollars as a way to supplant their own funding for public institutions. State investment in higher education has dropped from an all-time high of $8,274 per full-time equivalent (FTE) student in 2001 to $6,522 in 2014 in inflation-adjusted dollars. Instead of federal vouchers subsidizing institutions to keep tuition low, they have allowed schools to increase tuition with the knowledge that the increase would be covered by federal grants, loans, and tax credits. Tuition as a percentage of total public higher education revenue has jumped from 24.5 percent in 1989 to 47.1 percent in 2014.[7]

At the same time, there is compelling evidence to suggest that many four-year colleges are engaged in an elaborate shell game: using Pell Grants to supplant institutional aid they would have otherwise provided to financially needy students, and then shifting their own funds to help recruit wealthier students. This is one reason why even after historic increases in Pell Grant funding, low-income students continue to take on heavier debt loads than ever before. They are not receiving the full benefits intended.

Not only has this system led to more expenses for students—other consequences have emerged. Many colleges that benefit from this federal system of vouchers and tax credits do not serve students well. The average six-year graduation rate for those seeking a bachelor's degree at a traditional "four-year" institution is 59.4 percent.[9] In a survey of more than 1,000 public and private four-year colleges, only 51 percent of Pell recipients graduate.[10] At community colleges, only 23 percent of first-time, full-time students ever receive a degree.[11] There is also wide variation across colleges in how graduates fare in the labor market. Recent data released by the U.S. Department of Education found that at 27 percent of colleges, fewer than half of the students who enrolled and received federal aid were making more than the average high school graduate 10 years later.

Even for those graduating, many are likely not receiving a quality education. A 2006 study found only 31 percent of college-educated adults could correctly explain opposing newspaper editorials, while a different 2011 study found that after four years of college, 36 percent of students showed no improvement in critical thinking, complex reasoning, or communication skills.[12] Problems with the current voucher-based system are exacerbated by the lack of any meaningful quality control and accountability. Because key indicators of institutional quality remain unavailable, consumers are not able to make informed enrollment decisions, while federal policymakers cannot hold schools accountable for the federal dollars colleges receive.

We believe this system of vouchers, loans, and tax credits has proved untenable. There is a better way to improve accountability and outcomes, encourage state reinvestment, and ensure that students have access to an affordable education. This requires a complete re-envisioning of the way states, the federal government, and institutions fund higher education.

THE PLAN

Imagine a world where all student financial need is met. There are no federal loans, no Pell Grants, and no higher education tax credits. Instead, states receive formula funds for colleges that enroll a substantial share of low-income students and serve all students well. To be eligible for formula funds, states would be required to maintain, and encouraged to increase, their investment in higher education. Colleges would be required to enroll low-income students, charge only what students can afford, and demonstrate positive outcomes. This plan would eliminate unmet need for all students regardless of whether they are full-time or part-time, limiting the price they pay for college to their EFC. Additional federal, state, and institutional funds would make up the difference between a student's EFC and the net price at the participating institution.

This plan will:

- Change the allocation of federal higher education funding from a voucher program to a formula-funded grant program, eliminating federal loans and other current aid programs;
- Lower the cost for students to eliminate unmet need for living expenses such as room and board, transportation, and child care costs as well as tuition;
- Hold colleges accountable for student outcomes; and
- Strengthen the federal and state partnership by encouraging states to invest in both public and private higher education.

The Role of the Federal Government

The plan would eliminate the federal Title IV student aid programs including Pell Grants, student loans, and the Federal Supplemental Educational Opportunity Grant (FSEOG) program. In their place, the U.S. Department of Education would provide a federal formula grant to states. The federal contribution— which would account for factors such as the number of low-income students enrolled at participating institutions— would be large enough to encourage states to participate.

States would then be responsible for distributing the funding, along with their own contribution, to institutions that meet certain requirements. Ultimately, the federal government, states, and colleges would share the costs of eliminating unmet need and improving student outcomes.

The Role of States

States would be eligible for the new federal program if they agreed to maintain their higher education funding per FTE at a level equal to the average of the last five years, provide at least a 25 percent match for the federal formula grant, and play a more active role in holding colleges accountable for their performance and costs.

Under the plan, states would be required to allocate the federal money and state match to participating institutions. States could provide a larger match than is required, and they would receive additional funds from the federal government for doing so. States would be allowed to use a small percentage of the funds to administer the program, monitor institutional performance, and help colleges improve.

States could choose to opt out of the program, but would be unlikely to do so because they would forfeit all federal subsidies for their higher education systems. Losing this support would be politically problematic because tuition would increase substantially for middle- and upper-class voters. In addition, many colleges, powerful constituents in their own right, would have to close.

Students would be able to attend college in other participating states and pay only their EFC, regardless of whether their own state opts out. This is another benefit of the plan. Since states would be required to meet EFC for any student, including out-of-state students, it would decrease the out-of-state student arms race we have seen at some public institutions.[13] States could still give priority to in-state students by making tuition even less than EFC or creating admissions priorities for them.

The Role of Colleges

Colleges—whether public or private—in participating states could choose whether to opt into the program. Institutions that choose to participate would have to enroll a substantial share of low-income students, meet student financial needs by not charging any student more than their EFC, and meet the accountability performance measures outlined below. Schools that choose not to participate or do not meet the criteria will not receive any federal aid. While all types of institutions are eligible, we anticipate that many high-tuition schools will have a difficult time meeting demonstrated student need even with additional federal and state funding. Similarly, many of the lowest-quality institutions will need to improve substantially in order to meet the proposed benchmarks.

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IMPLEMENTATION

The Federal Government

The formula for distributing federal funding to states

The federal contribution formula would be based on the number of full-time equivalent students enrolled with different levels of family income at participating institutions within each state. This creates an incentive for states to encourage institutions to participate by providing additional federal funding to states with more students enrolled. Funding would be driven in part by the income level of each student. Those with the lowest familial resources would generate the largest per student funding. This sliding scale will ensure that states enrolling larger shares of low-income students will receive proportionally more funding to help cover the costs of their education. For example, a per-student award level could be set according to survey data on the national average of unmet need for students of different income levels. This allocation would then be adjusted annually to address shifts in population and demographics, as well as the overall rate of inflation. Structuring the federal disbursement this way would require schools and states to report enrollment figures by income category so that allocations could be adjusted as populations and economic circumstances change.

Bonuses to states and colleges

To participate in the program, states are required to match 25 percent of the federal award. The federal government would also encourage states to contribute an even greater amount through an additional bonus. This bonus would provide a 50 percent federal match for every dollar a state contributes above the initial 25 percent threshold. For example, states that contribute 35 percent of their original federal award would receive an additional 5 percent "bonus" from the federal government (that is, an amount equal to half of the 10 percentage-point increase over the baseline 25 percent contribution).

The federal government would also provide additional bonus funding to colleges that serve more than 25 percent low-income students, defined as those who would have previously qualified for the Pell Grant. This bonus would flow through states but would be required to go to the colleges that exceed the minimum low-income enrollment.

Both of these bonuses would be funded through the redistribution of dollars set aside for colleges that choose not to participate in the program but would not be subject to the 25 percent match.

Added protections on private student loans

Because this plan eliminates the federal student loan program, it is very likely that more middle- and upper-income students and families will turn to the private lending market to pay for college, since their EFCs are higher. Therefore, it will be critical for the federal government to reform private student loans to ensure that robust consumer protection mechanisms are in place to protect borrowers from harmful and predatory lending practices.

To accomplish this, the plan would reverse actions that Congress took in 2005 that made it nearly impossible for private loan borrowers to discharge their debt in bankruptcy. Private student loans should be treated like any other form of consumer debt.

We would also require lenders to offer in-school grace periods to private loan borrowers so that students could defer their payments while enrolled. Lenders would also be forbidden from putting private loans automatically into default if a co-signer dies or enters bankruptcy. In addition, colleges would be prohibited from including private student loans in financial aid packages that make the loans seem like a mandatory option for students to cover their expected contribution. The Education Department should consult with the Consumer Financial Protection Bureau for other possible protections when it regulates on these new changes.

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States

How funding will flow from states to colleges

States who opt into the program will be required to distribute the federal money to institutions that are participating in the program and meet all of the eligibility requirements. How states distribute that money is up to them. However, the money will need to be distributed in a way that supports colleges meeting the institutional requirements of the program: to enroll at least 25 percent low-income students, meet student financial need, and comply with the back-end accountability measures. Otherwise, the state risks decreasing the overall amount of money coming to them through the federal formula, since institutions would lose eligibility if they can no longer meet any of the above criteria.

States will be able to decide which colleges are allowed to participate in the program. More participating institutions means more federal money. On the other hand, colleges with high unmet need who do nothing to control costs could be excluded by the state. This new power will allow states to better coordinate their higher education systems including private non- and for-profit colleges.

State higher education governance and program administration

Federal funding would flow to the statewide higher education coordinating or governing board, which would then allocate the federal funds and the state match to colleges. Since some states do not have a centralized higher education board or commission, the governor would be responsible for identifying the state governmental agency that would administer the program.

Regulating published cost of attendance

States would have to regulate the published cost of attendance at participating institutions to prevent some institutions from artificially lowering the non-tuition components of cost of attendance and thus reducing the financial need of students who attend the institution. This would create a situation where the state and school would have to contribute less money toward the student's education. The U.S. Department of Education would conduct random audits of states to ensure that published non-tuition components of cost of attendance reflect what attending college actually costs.

Colleges

Application to the state

Institutions will need to apply to the state to be included in the program. During this application process, they will negotiate how to reach the requirements described below. States and institutions must meet the federally prescribed minimum standards, however, states will be given latitude to work with individual institutions to determine cost, accountability, and access strategies.

Low-income student enrollment requirement

To participate in the program, colleges will eventually have to enroll a student body in which at least 25 percent of the students are low-income. Most colleges and universities already meet this requirement. Using Pell eligibility as a proxy for low-income status, 89 percent of schools have a Pell enrollment over 25 percent, although this number is much higher at for-profit schools (96 percent) and lower for private nonprofits (80 percent). In terms of enrollment, 79 percent of students attend a school with more than 25 percent Pell recipients.

In order to encourage colleges to increase their socioeconomic diversity, this requirement would be phased in over five years. At the beginning of the program, colleges would have to meet a threshold of at least 15 percent Pell eligibility to participate. Only about 4 percent of colleges don't currently meet this benchmark.

Pricing requirement

Charging students only their EFC would represent a significant shift in the way most colleges handle pricing. Meeting the pricing requirement will often, but not always, require institutions to make investments in the form of lower tuition, or increased institutional aid for low-income students. Because some families still may not be able to meet the payments required under EFC, we also advocate for changing the way the EFC is calculated for some students and families (see page 14 for more detailed information).

Performance requirements

Many colleges that meet the front-end requirements for participation may no longer be eligible to participate in the program once accountability measures based on graduation and labor market outcomes of students are put in place. Schools and states will need time to meet these rigorous benchmarks of student success. Because of this, there will need to be a phase-in period for the accountability metrics.

ACCOUNTABILITY

Given the importance of higher education to students, states, and the nation, it is critical that public dollars are focused on colleges that serve students well. This proposal includes a set of outcomes-based accountability metrics designed to ensure that public dollars are well targeted and meet the needs of students for a high-quality, affordable education that leads to success after college.

We recognize that at least 34 states already hold public colleges and universities accountable in some way on a wide variety of performance indicators, including how many and what types of students they enroll compared to how many they graduate.[14] Based on what states have learned through these systems, the measures proposed here are designed to ensure that all states and the federal government collect comparable data on key outcome measures tied to the billions of dollars that support higher education.

We propose that states and the federal government collect information to support two distinct, but related, goals: 1] to ensure that public dollars are well targeted; and 2] to help students and families make well-informed decisions about their educational investments. The accountability metrics will focus on the number and percentage of students who progress through their educational program in a timely fashion, graduate or successfully transfer to the next step in an educational track, and secure employment that pays a family-sustaining wage after leaving college.

The reporting requirements will enable policymakers to disaggregate student outcome data along relevant criteria including student demographics and socio-economic status, programs of study, and institutional type, among others. The consumer information metrics will include all of the above, plus additional information on earnings beyond five years as well as outcomes relevant to particular programs, such as licensure passage rates.

Before implementing any specific measures, we anticipate that the U.S. Department of Education will consult with all the relevant stakeholders —colleges, universities, and their associations, the accrediting community, state and federal policymakers, and organizations representing students— to determine appropriate and reasonable thresholds for compliance. We also anticipate a process of consultation between federal and state officials charged with administering federal funding to inform the design of sanctions for institutions that fail to meet required thresholds and to formulate steps institutions can take to address weaknesses before and after losing access to federal funding. We also understand that there are significant differences among institutions— in their missions, selectivity, and many other facets of organization —and we recognize the importance of creating appropriate comparison groups and performance benchmarks. The process should balance institutional context with a primary obligation to the educational and financial well-being of individual students.

The federal government and states will have a shared responsibility to collect the data, monitor institutional performance, and implement institutional improvement plans and sanctions. States will be free to collect data on each of the measures and report them to the federal government, or allow institutions to report directly to the federal government. In order to ensure the most cost-effective and accurate method for collecting these progression and outcome measures, the existing ban on a federal student unit record system should be repealed. The U.S. Department of Education will be responsible for notifying states and institutions when they have failed to meet an accountability target and ensuring that states implement appropriate sanctions or improvement plans. The state agency charged with administering federal funding will also be responsible for developing and monitoring improvement plans for poor-performing institutions and administering sanctions on those that fail to improve.

THE PROPOSAL'S COST

We estimate that our proposal would cost the federal government $38.6 billion annually, on top of current spending levels. This figure includes the elimination of the Pell Grant program, the federal loan program, and all of the tuition tax breaks. States would contribute an additional $17.9 billion. Institutions are not specifically required to contribute their own funds to ensuring that all families are only charged their EFC. However, many of the most expensive schools would need to contribute funding through their own reserves, or other sources, in order to meet pricing requirements. At the same time, low-quality institutions would need to invest in improving outcomes in some way in order to remain eligible. See Appendix on page 21 for a detailed discussion about how we arrived at our cost estimate.

Changing the Way the EFC Is Calculated for Some Students and Families

Currently, families that do not have sufficient cash or liquid assets to meet their EFC, or that have other unavoidable expenses that take precedence, are able to access loans from the federal government in order to cover their costs. Eliminating the federal student loan program will require a reduction in the share of costs borne directly by students, which we have discussed throughout this proposal. However, creating an alternative funding mechanism for extenuating circumstances may also be necessary.

While the 38 percent of students with zero EFC would be unaffected by these concerns, we worry that high EFCs for other families may place college out of reach. For example, among students from families earning less than $30,000 annually, the average EFC is nearly $2,000 per year. While this may seem affordable for many families, unique circumstances may limit the actual amount a family is able to contribute toward the cost of college. This problem is particularly pressing for families with low- or middle-incomes that may not be able to access loans on the private market. To address this issue, we recommend altering the current EFC calculation to better account for each family's assets and obligations, including medical, housing, and transportation costs that limit the extent to which a family's income can be applied toward college expenses.

The current EFC calculation is based on post-tax income, utilizing a standard set-aside for living expenses based on the number of family members and college students in a given household. A similar number is then computed for each family's assets. A small percentage of each family's savings, investments, and any businesses owned is included, and an offset for education savings or other assets is subtracted from this value. Other proposals to reform the FAFSA and the related EFC calculation have experimented with new ways to balance simplicity with a well-targeted aid program. However, any modification to EFC creates difficulties in assessing the costs of the program (see Appendix for more information on how these estimates were calculated). For these reasons, we use existing measures of unmet need that rely on the EFC as the key metric of what students can afford.

We believe that the current FAFSA, which includes standard deductions for living expenses, is working well for most families. Therefore, in order to keep FAFSA simple enough for students and families to use, we propose the following two-part process.

First, we would use the existing process to calculate each family's EFC. For many families, including all of those with zero EFC, this process will adequately measure a family's financial circumstances. For these families, the process will stop here. However, if for some reason a family cannot meet their EFC, they could file a secondary hardship application to demonstrate liquidity constraints or other extenuating circumstances that prevent them from coming up with their share of costs. The calculation here should involve a documentation of other financial commitments, allowing them to make deductions to their EFC on the basis of these costs, rather than using a standard set-aside. Medical expenses, mortgage or rental payments for a family's primary residence, tuition payments for other students, and other necessary expenses should all be excluded from these families' EFCs.

While the EFC measures financial need adequately in most circumstances, the elimination of the loan program creates additional stress for families that are unable to pay for college due to extenuating circumstances. We believe this secondary process will address these issues, while leaving the EFC unchanged for most families.

ADDRESSING POTENTIAL CONCERNS

Isn't there a danger that states will not want to participate in this program?

We believe that states will want to participate in this program for the following reasons:

- First, instead of sending money to students and colleges, the federal government would provide money directly to states, giving state policymakers more leverage over their higher education systems. States would also receive a set-aside that they could use to help improve low-performing institutions and increase oversight of the colleges participating in the program.

- Second, states that choose not to participate in the program would be putting their students and higher education institutions at a significant disadvantage by depriving them of all federal subsidies that they have received in the past. Colleges have significant lobbying power with state governors and legislatures.

The only time a significant number of states have opted out of a program offering federal money was with the recent expansion of Medicaid, the health care program for low-income Americans. The 20 states that have so far turned down these funds did so in the context of a partisan fight over the passage of the Affordable Care Act in 2010.[15] But the number of states accepting the Medicaid expansion continues to grow. States do not routinely opt out of programs that fund federal highways, provide health insurance to uninsured children, and support low-income families, which require some degree of state matching or maintenance of effort.[16] In addition, states would face a lot of pressure on two fronts—from middle class voters who expect access to an affordable higher education system and from the institutions themselves that rely on state and federal subsidies to survive.

If, however, a state chooses to opt out of this program, its students would be eligible to attend college in other states paying only their EFC. This would add another reason for states not to opt out: They might lose their top students to other states.

Is there a danger that many colleges will choose not to participate in this program? What will happen to them?

We anticipate that some elite, high-priced colleges and universities will choose not to participate in this program. We believe that federal support for higher education should be more focused on providing high-quality and affordable educational options to students with financial need. This will benefit both students and society as a whole.

> **States that choose not to participate in the program would be putting their students and higher education institutions at a significant disadvantage by depriving them of all federal subsidies that they have received in the past.**

We believe that some high-achieving students will still choose to attend non-participating elite schools, many of which have large endowments that allow them to offer substantial amounts of institutional financial aid. Elite universities with multi-billion dollar endowments and legacy admissions policies for the children of the rich and powerful do not need scarce federal financial aid dollars. These schools may also be forced to lower their prices in response to the elimination of federal student loans and competition from schools participating in the program that are meeting the full financial need of students.

In addition, there will likely be a group of less selective and open access private nonprofit and for-profit institutions that could have difficulty meeting the full need of students under this proposal and may not be able to participate in the program. We do not believe, however, that our plan would limit access to college for low- and middle-income students. Because it is likely that most public colleges and universities will opt in to the program, many students who would have attended those pricier private institutions will still be able to attend elsewhere.

TRADE-OFFS

A change of this magnitude inevitably involves trade-offs between competing priorities. We discuss some below.

Providing direct support to institutions vs. maintaining a voucher system for students

In deciding how best to improve student outcomes and help students with unmet need, we considered whether to better target the current voucher model or to create a new program that directly invests in institutions.

As stated above, the voucher model has proven ineffective over time. Grants, tax credits, and loans all favor schools that charge high tuition. Schools that charge low tuition don't reap the full reward. The existing voucher system has virtually no quality standards or accountability measures. And because colleges can charge high tuition, students can still be priced out or forced to take on high debt loads to attend schools of questionable quality. The voucher system depends on students and families making rational, informed choices, but Congress, when it banned the creation of a federal unit record system in 2008, made it impossible to adequately compare colleges on important outcome measures. Students often choose schools that poorly serve them.

If colleges and universities are supported by the taxpayer, they should be publicly accountable for the prices they charge and the quality of the education they provide.

Keeping federal loans vs. abolishing federal loans

Students and colleges have become increasingly reliant on taking out student loans to pay for college, leading to a huge increase in debt over the past 30 years with no end in sight. Many of the most prominent higher education reform proposals simply take this as a given, and focus on extraordinarily expensive and increasingly complicated mechanisms for managing the cost and affordability of student loans by manipulating interest rate subsidies, loan repayment rates, debt caps, forgiveness schedules, and the like. Many of these policies have individual merit, and New America has written about their flaws and virtues at length. Until the loan system is replaced by something better, we will continue to do so.

But optimizing the higher education debt system does not change the fact that student loans are a bad way to publicly finance and subsidize higher education. Because our proposal requires the federal government, states, and colleges to meet the full need of undergraduate students, we don't believe that federal student loans are required. In addition, we believe that maintaining the federal loan system has shielded institutions from market pressures to contain costs, enabling them to raise their cost of attendance over time. There is no reason to believe this trend will reverse without a drastic overhaul of the federal aid system. The clear lesson of recent decades is that uncontrolled student debt has malign effects on everyone involved. It turns young people into debtors, the U.S. Department of Education into a collection agency, and colleges into organizations whose financial well-being depends on inducing naïve students into making often-ruinous financial choices. Any reform proposal that maintains the student debt system is aiding and abetting the continuation of this status quo.

We understand that because this proposal eliminates the federal student loan program, some undergraduates will have to take out private loans. As a result, we believe that the government should impose robust consumer protections on the private student loan market, as noted earlier in the report. We also considered keeping federal loans for graduate school but decided that a well-regulated private market could address most of the needs of graduate students.

Including all colleges in the plan vs. including only public colleges and universities

There are very few truly "private" institutions of higher education in the United States. Nearly all colleges receive federal student aid dollars, and many nonprofit and for-profit schools would close if they didn't have access to Pell Grants, student loans, and tax credits. That means these institutions are, at least partially, already public. Additionally, there is nothing about the "status" of an institution of higher education that tells us inherently whether or not it is good. For-profits are currently singled out for federal regulation because of legal limitations on the nature of the regulated program (those that lead to "gainful employment") and because they tend to respond most aggressively to the poor system of incentives created by the voucher system, which has sometimes led to abuses. With that in mind, we determined that any institution—public, private nonprofit, or for-profit—can participate in the new program. All schools are held equally accountable under the guidelines laid out in this proposal, especially when it comes to the EFC calculation.

Keeping the plan simple vs. complex and well targeted

In 2014, Republican Tennessee Governor Bill Haslam announced that graduates of high schools in the state who meet certain requirements would be able to attend community college for free. Many recent policy proposals have followed Tennessee's lead, including legislation proposed by Senator Tammy Baldwin (D-Wis.) that calls for making the first two years of college free nationwide for students.

"Free college" is a great message—it is simple, understandable, and sounds good. The problem is that this idea does not focus resources on the students who need the most support. Instead, it extends the same level of subsidy to everyone, greatly increasing the overall cost of the program, and making college free for students who could very well afford to pay some of their higher education costs. It also leaves students who attend college less than half-time and those who are less academically successful (most of these plans come with GPA requirements) without a benefit that could help them succeed.

While New America's plan is more complex in terms of defining the benefits students would receive, it is also more targeted, by covering the financial need that truly exists. In other words, the proposal would provide more aid to students who need a larger subsidy, and less for students with very little or no need.

Including an EFC phaseout vs. imposing a cutoff

The primary purpose of our proposal is to generate affordable options for low-income students pursuing higher education. However, targeting our program to help only those below a set income threshold would create an arbitrary cutoff, in which students whose family income is just above the cutoff would be charged dramatically higher prices than those just below. Additionally, we worried that by requiring low net prices for low-income students, institutions would respond by driving up costs for middle-income students who don't qualify for Pell Grants. While some of these students may be able to afford tuition payments as they currently stand, this risks further inflating costs for middle- and upper-income students to an unsustainable point.

Indeed, 80 percent of the costs of this program go toward providing tuition assistance to families earning less than $48,000 per year. The cost of extending this program to all students with financial need is much lower than the core investment in the poorest families.

We chose the existing federal EFC as a phaseout mechanism because it is already widely used, measures need well for most families, and provides a well-designed phase-out process. However, the EFC may not always accurately represent the financial health of families with liquidity constraints or other unique circumstances. While other affordability metrics and reforms to EFC have been proposed, the data are insufficient to address the costs of limiting tuition to any of these measures.[17] We recommend policymakers consider key reforms to the EFC in order for it to function more seamlessly for college students and more effectively meet need in all cases (see page 14 for more information).

As part of our accountability metrics, relying on earnings vs. learning outcomes as a proxy for quality

We acknowledge that earnings are a limited and imperfect measure of the quality of an educational program or institution. Intellectual development, broadly defined, is the core mission of higher education, and extends well beyond career preparation.

With that in mind, we discussed the feasibility of including additional outcome metrics that would capture learning outcomes. We considered exams like the Collegiate Learning Assessment Plus (CLA+), or requiring states to develop their own strategies for measuring learning in participating schools. But we concluded that none of the existing instruments or strategies are sufficiently well-developed to merit inclusion in an accountability system, although they may be valuable to include for informational purposes. Standardized testing seems particularly ill-suited for measuring program-level learning at the college level, where programs of study are so diverse. Exit examinations that are low-stakes for students may also under-measure learning, since students don't have an incentive to try their hardest on the tests.

In the absence of established and comprehensive techniques for measuring learning across programs and institutions, we opted in favor of outcome metrics that can be reliably collected and would enable comparisons that are valuable to both students and policymakers: graduation and earnings. Recognizing that some academic programs are likely to generate earnings returns more quickly than others, we include measures of earnings one, three, five, and 10 years out. While earnings are not a direct measure of educational quality, they help prospective students and their families prepare for the future and set appropriate expectations. They also help policymakers at the institutional, state, and federal level identify programs that are not helping students become economically self-sufficient.

Earnings provide a baseline level of consumer protection and quality assurance. We are not suggesting that social workers or teachers who earn less on average than chemical engineers received a less valuable or a lower-quality education. If, however, a program's graduates – whether they are bankers, engineers, or teachers – consistently made minimum wage or no more than high school graduates, we would question the value of that particular institution's program.

Our decision to focus on economic outcomes does not preclude efforts to develop comprehensive and reliable measures of student learning that could be incorporated into future accountability systems. We strongly support efforts like the Valid Assessment of Learning in Undergraduate Education (VALUE) initiative led by the Association of American Colleges & Universities (AAC&U), as well as the State Higher Education Executive Officers (SHEEO) initiative that is developing and testing common learning outcomes and assessment rubrics for the liberal arts across more than 60 institutions in nine states.[18] We also believe that professional and industry associations can be valuable partners in efforts to identify key learning outcomes and develop appropriate assessment methods and tools. Faculty-led efforts to develop authentic assessments in the disciplines will also be crucial.

Some college leaders may argue that our focus on earnings will damage the attractiveness or prestige of liberal arts programs or institutions. We disagree. There is evidence that a good liberal arts education provides a strong foundation for future career success. The market for an education in the arts and humanities functions reasonably well – it's not a secret where the expensive liberal arts schools are. We see little reason to believe that measuring earnings, particularly as we look at indicators like poverty-level wages and wages compared with those of high school graduates, will disadvantage liberal arts schools. To the contrary, we fully expect that greater transparency around earnings will help dispel anxieties about the value of liberal arts, making the decision to major in those subjects less fraught for students and parents.

CONCLUSION

New America welcomes the renewed public focus on the affordability of higher education for all Americans. But so far, every presidential plan to address the price of college by leveraging additional state investment has simply layered on to the current fragmented system of higher education finance. This system is broken beyond repair.

If the federal government is going to pursue a new partnership with states, we must create an entirely new system for funding postsecondary education. This white paper lays out a form for that system. We believe it would halt state disinvestment, fulfill student financial need, and improve how higher education serves low-income students. It is time to stop the spread of student debt and make college affordable once and for all.

APPENDIX: CALCULATING THE COSTS OF OUR PROPOSAL

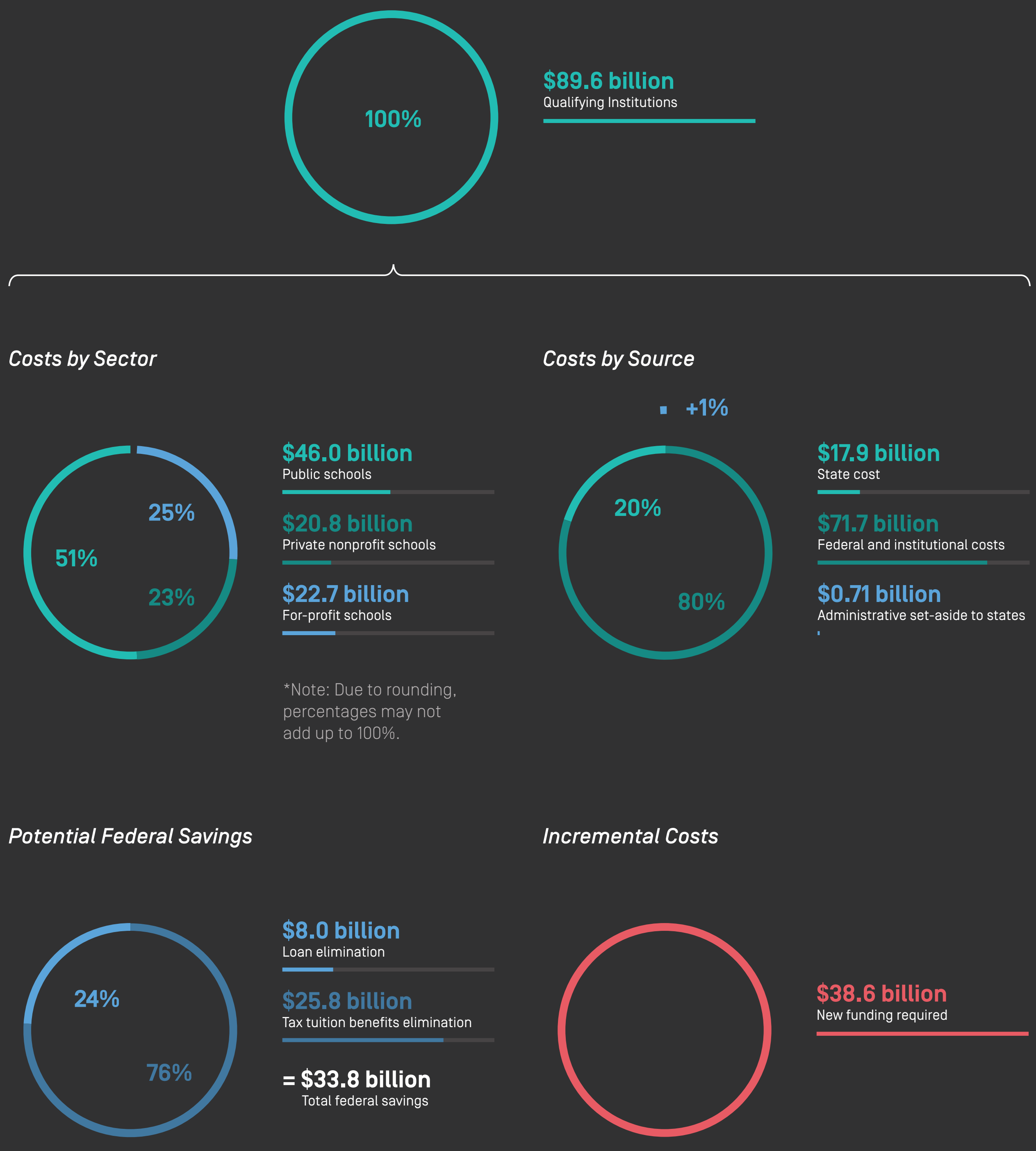
Total cost of eliminating unmet need

The incremental federal funding needed for this project, when combined with proposed cost-saving metrics, is $38.6 billion annually, including a 1 percent administrative set-aside of $710 million for states. We expect the adoption of our proposal would cost the federal government $71.7 billion annually, supplemented by $17.9 billion in matching funds from states. All cost estimates are inflation adjusted to 2015 dollars (see Figure 2).

To construct these cost estimates for the undergraduate population, we use average unmet need among federally aided students as estimated through National Postsecondary Student Aid Study for the 2011-2012 school year, along with IPEDS enrollment counts, and the share of students who receive any form of aid at each school. These calculations are done separately for full- and part-time students. Notably, part-time students have much lower unmet need, on average, but are also likely to take longer to complete a degree. We acknowledge that our plan fundamentally alters the incentive structures of students, institutions, and states. Because of this, assessing the program's actual cost could be incredibly complex. We decided to go with a more straightforward approach, estimating costs based on the system of higher education as it currently exists.

A combination of federal and state resources would be necessary to cover these costs, which includes more than $46 billion for students at public four-year colleges, $20.8 billion for students at private nonprofits, and $22.7 billion for students at private for-profits, based on current enrollment. Certain institutions would elect not to participate, and many others would be ineligible due to the accountability requirements we have included in our plan. Still others would need to chip in their own resources to simultaneously lower costs to students while maintaining or improving quality. Based on current data, for-profit institutions would have the most difficulty in meeting accountability and price requirements, meaning that many of these schools would be ineligible to participate. We have proposed redirecting funds for these ineligible institutions to provide bonuses for states that contribute more than the 25 percent match, and to schools that enroll more than 25 percent Pell students. It follows that much of the money set aside for these ineligible schools would ultimately be redistributed in the form of bonuses to other, more successful schools. Indeed, public institutions would generally be the most likely to maintain eligibility, given current price structures and performance measures at these institutions. Overall, these new costs, combined with our proposed cost-saving measures, including the elimination of both federal student loans and tuition tax benefits, brings the total additional cost down to about $38.6 billion.

Figure 2: Estimated Costs of Meeting EFC, in 2015 Dollars



Source: New America's analysis of U.S. Department of Education National Postsecondary Student Aid Study, 2012; Integrated Postsecondary Education Data System, 2012.

A separate analysis conducted by New America concluded that the bulk of the program costs would come from closing the gaps for families earning below $30,000 per year. Indeed, approximately 63 percent of the costs goes to these low-income families, while nearly 80 percent of the costs goes to families earning under $48,000. By sector, public institutions account for 40 percent of the total costs of the program, and for-profit schools account for 34 percent, with the rest of the cost going to students at private nonprofits. Because the largest share of the funding is serving low-income students at public institutions, extending the program to all college undergraduates enables us to phase out benefits as income increases, and make college affordable for middle-class families as well as those of more limited means.

Cost savings from eliminating existing federal aid programs

While our proposal eliminates Pell Grants, along with much of the existing federal aid system, the majority of these dollars cannot be counted toward the new costs of the program, since the reduction in federal grant aid directly to students will increase the unmet need of current Pell recipients.

However, eliminating the loan program would save $8 billion under fair value accounting methods in 2015. While the CBO does not use these methods, we believe the fair value estimates provide a more accurate reflection of actual risk-adjusted costs incurred in federal direct lending. We also believe eliminating all tuition-related tax benefits could be an additional source of funding for this project. Because the tax benefits are largely justified as a way to provide financial assistance to middle-class families, our proposal may lessen the need for tax relief to promote affordability in higher education. Doing so would save $25.8 billion in tax year 2015. This leaves about $38.6 billion in incremental funding needed to put our plan into effect.

NOTES

[1] See Mitchell, Josh. "School-Loan Reckoning: 7 Million Are in Default." (New York: Wall Street Journal, 2015). http://www.wsj.com/articles/about-7-million-americans-havent-paid-federal-student-loans-in-at-least-a-year-1440175645z

[2] For more on the Federal Pell Grant Program see https://ifap.ed.gov/dpcletters/attachments/GEN1502Attach.pdf

[3] See Adam Looney and Constantine Yannelis. "A crisis in student loans? How changes in the characteristics of borrower and in the institutions they attended contributed to rising loan defaults." (Washington DC: Brookings, 2015).

[4] Ibid

[5] For an analysis of the federal student loan portfolio see https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/PortfoliobyLoanStatus.xls.

[6] See Delisle, Jason and Dancy, Kim. "A New Look at Tuition Tax Benefits."(Washington DC: New America, 2015). https://static.newamerica.org/attachments/10416-a-new-look-at-tuition-tax-benefits/TaxCredits11.2.f8dba693bbc14428954c848bcb6b8b7c.pdf and Burd, Stephen. "Moving On Up: How Tuition Tax Breaks Increasingly Favor the Upper Middle Class." (Washington DC: New America, 2012) http://educationpolicy.air.org/sites/default/files/publications/TaxCredit_CYCT_RELEASED.pdf

[7] Colleges and universities need a certain amount of funding per student to provide a quality education. When state funding does not keep up with enrollment growth, it is in effect a cut in per student funding even if total funding does increase. This is why New America chooses to use state funding per FTE as the metric here. For an analysis of SHEF 2014 data, see http://www.sheeo.org/resources/publications/shef-%E2%80%94-state-higher-education-finance-fy14.

[8] Ibid

[9] Statistics is of first-time, full-time students who began at a four-year institution. There are no reliable data on students who started at a community college and transferred. For more see National Center for Education Statistics. https://nces.ed.gov/ipeds/trendgenerator/tganswer.aspx?sid=7&qid=20.

[10] See Nichols, Andrew Howard. "The Pell Partnership: Ensuring a Shared Responsibility for Low-Income Student Success." (Washington DC: The Education Trust, 2015). https://edtrust.org/wp-content/uploads/2014/09/ThePellPartnership_EdTrust_2015.pdf

[11] First-time, full-time students at public two-year colleges who receive any degree, including certificates. For an analysis of college scorecard

data see collegescorecard.ed.gov.

[12] Kutner, Mark, Greenberg, Elizabeth, and Baer, Justin. "A First Look at the Literacy of America's Adults in the 21st Century. NCES 2006-470," U.S. Department of Education National Center for Education Statistics, (2006), http://www.eric.ed.gov/ERICWebPortal/detail?accno=ED489066.; and Arum, Richard and Roksa, Josipa. "Academically Adrift: Limited Learning on College Campuses" (Chicago: University of Chicago Press, 2011).

[13] Burd, Stephen. "Undermining Pell: How Colleges' Pursuit of Prestige and Revenue is Hurting Low Income Students." (Washington, DC: New America, 2014). https://www.newamerica.org/downloads/UnderminingPellVolume2_SBurd_20140917.pdf

[14] See http://www.ncsl.org/research/education/performance-funding.aspx

[15] For more on Status of State Action on the Medicaid Expansion Decision see http://kff.org/health-reform/state-indicator/state-activity-around-expanding-medicaid-under-the-affordable-care-act/#note-5

[16] For more on Federal Grants to State and Local Governments see https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/03-05-13FederalGrants_onecol.pdf

[17] For more information on these proposals, see "Measuring College Affordability: Lumina's Rule of 10 and the Federal EFC"; "NASFAA's Take on Data for the FAFSA"; "NASFAA's Three Paths for FAFSA Applicants"; "Right on Schedule: Gates Proposes Simplifying the FAFSA"; and, "Gate's FAFSA Proposal: What Would This Mean for Families?" Available on EdCentral.org

[18] See VALUE Rubric Development Project https://www.aacu.org/value/rubrics and Lederman, Doug. "Are They Learning." (Washington DC: Inside Higher Ed, 2015). https://www.insidehighered.com/news/2015/09/25/new-effort-aims-standardize-faculty-driven-review-student-work