

# Reforming Student Aid

*How to Simplify Tax Aid and Use Performance Metrics to Improve College Choices and Completion*



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# Contents

- Acknowledgements** **i**
  
- Executive Summary** **1**
  
- I. Reforming Student Aid to Better Meet Student and Parent Needs** **9**
  - TWIN CHALLENGES: AFFORDABILITY AND COMPLETION 9
    - College costs are growing far faster than family incomes, driven in part by declining state and local funding for higher education. 10
    - High unmet need makes college a riskier investment for students and families. 11
    - Financial pressures drive down college completion. 12
  - CLASP’S GUIDING PRINCIPLES FOR REFORMING FEDERAL STUDENT AID 14
  
- II. Making Tax-Based Student Aid Simpler and More Effective** **17**
  - WHY REFORM TAX-BASED STUDENT AID? 20
    - Tax-based aid provides little benefit to the lowest-income students. 20
    - Tax-based aid does little to incentivize college enrollment and completion. 21
    - The system of tax-based aid is complex and difficult to use. 22
  - HOW TO REFORM TAX-BASED STUDENT AID 22
    - Improve the American Opportunity Tax Credit. 23
    - Simplify and better target tax-based student aid. 29
    - Expand outreach and pilot “real-time payment” of the American Opportunity Tax Credit. 34
  - COMBINING REFORM OPTIONS TO SIMPLIFY AND IMPROVE TAX-BASED STUDENT AID 38
    - PROPOSAL ONE:** Simplify aid to just the American Opportunity Tax Credit and front load refundability. 39
    - PROPOSAL TWO:** Simplify aid but preserve both the American Opportunity Tax Credit and the Lifetime Learning Credit for undergraduates only. Front load refundability of the AOTC. 41

<p><b>PROPOSAL THREE:</b> Simplify aid but preserve both the American Opportunity Tax Credit and the student loan interest deduction. Front load refundability of the AOTC.</p>	42
<p><b>III. Using Performance Metrics to Address Affordability and Completion Challenges</b></p>	<b>45</b>
<p>CURRENT AND POTENTIAL USES OF PERFORMANCE METRICS</p>	46
<p>    Applications of metrics</p>	47
<p>    Types of metrics</p>	49
<p>CLASP’S GUIDING PRINCIPLES FOR USING METRICS IN HIGHER EDUCATION REFORM</p>	51
<p>FEDERAL POLICY REFORM PROPOSALS</p>	52
<p>    <b>PROPOSAL ONE:</b> Expand public reporting of institutional measures of affordability, student progress, and credential completion.</p>	53
<p>    <b>PROPOSAL TWO:</b> Require states to gather and disclose aggregate student employment and earnings for all programs of study.</p>	55
<p>    <b>PROPOSAL THREE:</b> Create a national, voluntary Compact for College Completion for students and colleges.</p>	58
<p><b>V. Conclusion</b></p>	<b>61</b>
<p><b>Appendix 1: Revenue Estimates for CLASP Tax-Based Student Aid Options and Proposals</b></p>	<b>63</b>
<p><b>Sources</b></p>	<b>69</b>



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## About the Center for Postsecondary and Economic Success at CLASP

The Center for Postsecondary and Economic Success is a policy and advocacy initiative within CLASP. The mission of the Center is to work for policies and investments that can increase the number of low-income adults and disadvantaged youth who earn marketable postsecondary and industry credentials that are essential to opening doors to good jobs, career advancement, and economic mobility.

CLASP develops and advocates for policies at the federal, state and local levels that improve the lives of low-income people. In particular, we seek policies that strengthen families and create pathways to education and work. For more information, visit [www.clasp.org](http://www.clasp.org).



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# Executive Summary



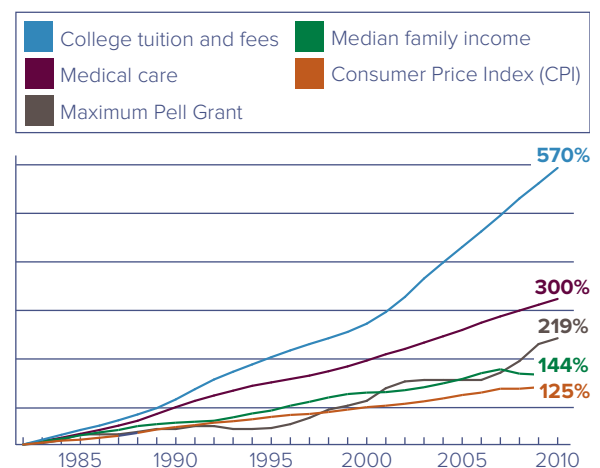
College costs are growing far faster than family incomes. Nearly half of students at public colleges have substantial unmet need.

Over the last three decades, college costs have increased nearly four times faster than median family income (*Figure A*). Financial aid has not filled the growing gap, and “unmet financial need”—the share of college costs not covered by financial aid or what the family is expected to contribute—has risen sharply. Half of community college students had unmet financial need in 2007-08, averaging \$4,500, as did 43 percent of students at public four-year colleges, with their unmet need averaging \$6,400 (National Center for Education Statistics 2011).

As a result, students work more and borrow more, with debt now averaging more than \$26,000 for recent four-year college graduates (Reed and Cochrane 2012). Rising costs and rising debt make college a riskier investment for students and families, who lack the information they need to shop around for colleges and programs of study that represent the best value in

**Figure A: College Costs Rising Four Times Faster Than Income, Two and a Half Times Faster Than Pell Grants**

Rate of cost growth in higher education and other goods compared to growth in Pell Grants, 1982-2011



**Source:** Darcie Harvey (National Center for Public Policy and Higher Education) and CLASP analysis based on data from the Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers. Median family income is from U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements and the American Community Survey. Maximum Pell Grant from Department of Education, Pell Grant End-of-Year Report (2010-2011). Adapted from figure in *Lifting the Fog on Inequitable Financial Aid Policies*, Lynch, Engle, and Cruz (2011).

terms of cost, completion rates, and employment and earnings (or further education) after graduation.

### Financial pressures drive down college completion.

Lack of affordability not only limits access to college, it also affects the time it takes for students to earn a degree. For example, two-thirds of young community college students work more than 20 hours per week to cover college and family costs (Orozco and Cauthen 2009). This may explain in large part the widespread prevalence of part-time college attendance. A recent national study found that more than half of undergraduates (51 percent) attended a mix of full-time and part-time over a six-year period (Shapiro et al. 2012).

Beyond increasing time to degree, financial pressure to work more while in college—and consequently take fewer classes at a time—also affects whether students ultimately complete a certificate or degree program and earn a credential. A number of studies have found that working too many hours while in college negatively affects academic performance (Scott-Clayton 2012). A 2009 survey of young adults who had left college is consistent with this: 54 percent of students who had left school said the major reason was because they had to “go to work and make money” (Johnson and Rochkind 2009).

Reducing the pressure to work too many hours while in school might help explain why need-based grant aid not only increases college enrollment among low- and modest-income students but can also increase persistence and credits earned (Castleman and Long October 2012; Goldrick-Rab et al. 2012). But other factors can also stand in the way of student success, including logistical barriers (e.g., child care, transportation), poor high school academic preparation for college, and lack of knowledge about navigating complex college academic and financial processes (Bailey, Smith Jagers and Jenkins 2011). Some financial aid programs have coupled grant



aid with other interventions (e.g., innovations in course delivery, curriculum, or instruction; learning communities; financial incentives; extra academic support and advising; emergency transportation or child care help) to address these obstacles. Early research suggests that such multifaceted approaches may be even more effective than grant aid alone (Scrivener, Weiss and Sommo 2012; Deming and Dynarski 2009; Washington State Board for Community and Technical Colleges 2011).

**Federal student aid reform should be fair and increase educational and economic opportunity. Back proposed changes with evidence and model or pilot the consequences before adopting new policies.**



CLASP recognizes that changes to federal student aid should not be proposed lightly, especially at a time when policymakers are focused on budget austerity rather than on the nation's linked college affordability and completion challenges. Accordingly, we have developed principles for guiding student aid reform choices.

First, the goal of federal higher education policy should be to increase educational and economic opportunity for all students, with a priority for low-income, underrepresented populations who cannot access and afford postsecondary education without federal assistance.

Second, federal student financial aid reforms should preserve—and even enhance—the original purpose of these programs: to increase access. Student success and completion are worthy additions but should be pursued in ways that do not undermine access. Reforms should be fair and recognize the diversity of today's students.

Third, any reforms should make federal student aid:

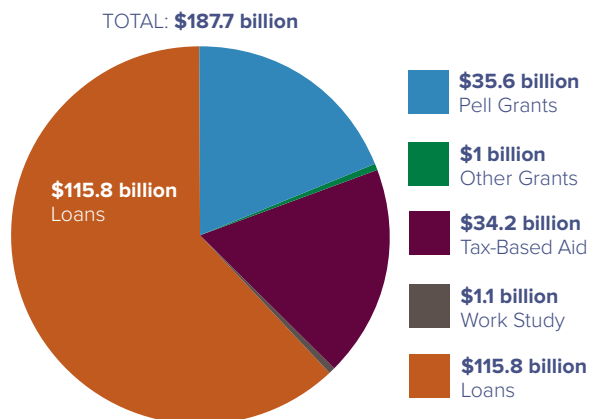
- *More effective*, in terms of increasing access to and completion of college by low-income underrepresented populations,
- *More efficient*, in terms of maximizing the impact of limited federal dollars, and
- *Simpler* for students and their families to understand and use.

Fourth, in looking forward, CLASP strongly believes that all policy reform proposals must pass a high bar before being moved forward for legislative or executive action. In our view, reform proposals should be *evidence-based*, with data backing the need for change and showing that proposed changes will help, not hurt, needy students; *modeled*, to show clearly any redistributive effects among students and families; and *piloted*, to understand the actual effects on students and institutions before major changes are scaled up.

Based on these considerations, CLASP has focused our work for the Bill & Melinda Gates Foundation project *Reimagining Aid Design and Delivery* on two federal policy areas that have received relatively little congressional attention and where we see considerable room for improvement: tax-based student aid and the use of performance metrics in student aid policy. We oppose any further cuts to the Pell Grant program as unnecessary and counterproductive to federal goals for increasing college access and completion. Not only are Pell Grants well targeted to the families that need help most, but growth in the program has leveled off. Students cannot afford any further Pell Grant reductions; next year's \$5,635 maximum Pell Grant will cover less than one-third of the cost of college—the lowest since the start of the program.

The Pell Grant program does face a funding gap beginning in fiscal year 2015 (FY 2015), with the ending of an existing revenue source. Congress should look for savings elsewhere in student aid to fill that gap. Pell Grants represented less than one-fifth of all student aid provided to students in the last fiscal year (*Figure B*). As *Figure C* indicates, a substantial portion of tax-based student aid flows to upper-income households whose college

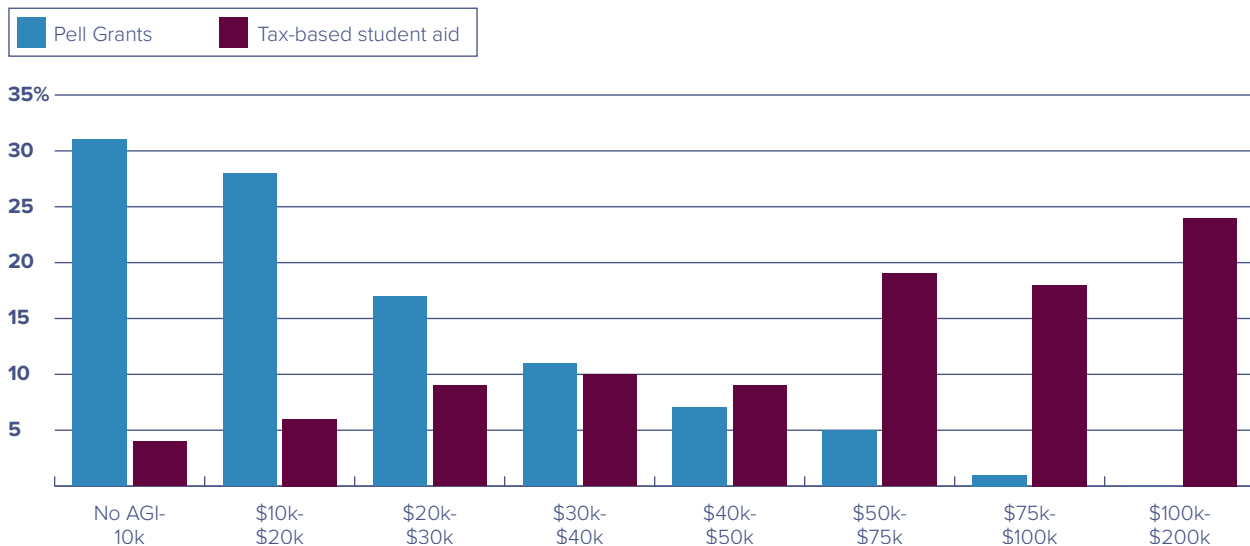
**FIGURE B: Pell Grants Represent Less Than One-Fifth of All Federal Student Aid, FY 2012**



Source: CLASP, based on estimates from the President's FY 2013 Budget and the Department of Education.

**FIGURE C: Tax-Based Student Aid Provides Substantial Benefit to High-Income Households**

Percent distribution of student aid by type and income category in 2013



**Notes:** “Tax-based student aid” here includes the American Opportunity Tax Credit, the Lifetime Learning Credit, the student loan interest deduction, and the tuition and fees deduction.

**Source:** CLASP, based on data from the Tax Policy Center.

decisions are unlikely to depend on receiving a tax deduction or credit.

### Make tax-based student aid simpler and more effective.

There are three main criticisms of tax-based student aid: it provides little benefit to low-income students, it has little effect on college access or completion, and it is too complex and difficult to use. Our exploration of various reform options makes it clear that it is possible to address these problems by simplifying and better targeting federal tax-based student aid—and potentially redirecting some revenue savings to the Pell Grant program—within a budget neutral framework. While delivering student aid through the tax system is a “second best” strategy compared with grant aid, because Congress has chosen to deliver nearly half of all non-loan student aid in this way, it is essential to make it work better.

These options can be packaged in various ways to achieve different goals. CLASP has created three alternative proposals that provide a general framework

for reform. All rely on improving the American Opportunity Tax Credit (AOTC) and simplifying the array of available tax benefits. These are:

### Proposal One: Simplify aid to just the American Opportunity Tax Credit and front load refundability.

This proposal would refund 100 percent of the first \$2,000 of the AOTC and index the AOTC for inflation. It would also lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and begin at \$60,000 and end at \$90,000 for single and head of household filers. In addition the proposal would eliminate the tuition and fees deduction, the Lifetime Learning Credit (LLC), and the student loan interest deduction. Compared with current policy, this reform package makes tax-based student aid much simpler for students and parents to understand and delivers significantly more of that aid to the most price sensitive households to increase its impact on access and completion. This proposal is essentially revenue neutral.

**Proposal Two: Simplify aid but preserve both the American Opportunity Tax Credit and the Lifetime Learning Credit for undergraduates only. Front load refundability of the AOTC.**

Proposal Two would preserve many of the benefits of Proposal One while addressing its potential shortcomings. This proposal would refund 100 percent of the first \$1,500 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single tax filers; eliminate the student loan interest deduction and the tuition and fees deduction; and eliminate the Lifetime Learning Credit for graduate students only. Proposal Two preserves tax-based aid to certain groups left worse off by full elimination of the Lifetime Learning Credit under Proposal One, such as undergraduates who are in their fifth year of studies, are attending less than half time, or are not seeking degrees. However, it provides significantly less aid to the lowest income households than does Proposal One. The package is modestly revenue positive, which would leave open the possibility of these revenues being redirected to help address the Pell Grant funding gap and to fund innovation aimed at increasing completion.

**Proposal Three: Simplify aid but preserve both the American Opportunity Tax Credit and the student loan interest deduction. Front load refundability of the AOTC.**

Proposal Three is similar to Proposal Two but with two major differences: it preserves the student loan interest deduction and eliminates the Lifetime Learning Credit. This alternative reflects that Congress' recent action to make permanent the expanded student loan interest deduction may signal a lack of interest in eliminating this benefit as part of tax simplification. Like the first two proposals,

this package simplifies and better targets tax-based student aid but it provides slightly less aid to low- and modest-income families than Proposal Two and has the same negative effects on current undergraduate recipients of the Lifetime Learning Credit that Proposal One does. Proposal Three generates a modest amount of revenue that could be reinvested in the Pell Grant program and innovation.

The above proposals rely on the same general strategy to make the tax provisions more efficient, effective, and simple. Adjustments, such as altering the refundability rate or relying on an alternative set of eliminations, could be made to meet certain goals (e.g., securing more revenue for the Pell Grant program and for innovation).

In addition to these three proposals, we believe two other AOTC improvements should be adopted that would ensure nontraditional students can fully benefit from this important source of student aid. First, expand the definition of qualified expenses to include child care and transportation. Second, replace the four-year AOTC limit with a lifetime \$10,000 limit. These two improvements are not included in the above proposals because it is not possible at this time for us to obtain revenue estimates for them. We are however able to evaluate the budgetary and distributional implications of expanding qualified expenses to align with the full Title IV cost of attendance definition (see Option 1 in Section II).

Whatever the package of tax-based aid improvements and simplifications that policymakers choose, we urge them also to consider reforms that would improve outreach and delivery of tax-based student aid to make it more useful to all households (see Options 9-12, Section II). Without such reforms, timing and information problems will always constrain the impact of tax-based student aid. In particular, we urge policymakers to:

- Require more aggressive outreach, including IRS-supported free tax-filing help, to increase receipt of the American Opportunity Tax Credit among eligible low-income students and parents.



- Test “real-time payment” of the AOTC to postsecondary institutions through a joint Treasury-Education pilot.
- Add the AOTC to the Department of Education “Financial Aid Shopping Sheet” and require all Title IV institutions to use the Shopping Sheet.

Provide students, policymakers, and colleges with the facts they need, and create federal incentives for students and colleges to partner on college completion.

Performance metrics have long been used in other public programs for diverse purposes, and they could be used in federal higher education policy to promote the goals described earlier. Current performance requirements for student eligibility for aid already strike a balance between the goals of access and student success. However, much less attention has been given to institutional performance metrics in federal policy. CLASP presents a framework of potential uses for institutional performance metrics in order to contribute to a thoughtful discussion about what might be most appropriate.

We also propose several reforms for producing more-relevant performance information for students, policymakers, and colleges and for incenting and supporting students and institutions to increase college completion. These proposals are:

**Proposal One:** Expand public reporting of institutional measures of affordability, student progress, and credential completion.

Expanded reporting should include key measures of *institutional access and affordability*, *interim measures of student progress*, and better reporting of *credential and degree attainment rates*. We also recommend a stronger role for the Department of Education and the National Center for Education Statistics (NCES) in developing common definitions and data elements, and

we would modify Higher Education Act requirements to ensure that Pell Grant graduation rates, transfer policies, and key data on costs are reported publicly. We also recommend simplifying Title IV disclosure and reporting requirements.

**Proposal Two:** Require states to gather and disclose aggregate student employment and earnings for all programs of study.

This reporting should include results for those who complete and who do not complete a certificate, diploma, or degree. The aggregate results from these data at the institutional level should be available publically to improve student and parent college program choices. A key aspect of this option is to build on existing State Longitudinal Data System grants to require states to develop a common definition of postsecondary program enrollment and standardized collection of data on certificate and degree attainment. Similarly, Workforce Data Quality Initiative grants could be expanded to require inclusion of data on Unemployment Insurance earnings as part of longitudinal student records accessible through the SLDS. The aggregate results could be submitted to the U.S. Department of Education for use by NCES to expand institutional-level profile information to include employment and earnings results for all programs of study (not just occupational programs).

**Proposal Three:** Create a national, voluntary “Compact for College Completion” among the federal government, students, and colleges.

This Compact would provide financial incentives and national recognition to students and colleges that agree to partner with the federal government on college completion. “Compact Scholars” would receive rewards for staying enrolled continuously and making progress in programs of study. Colleges would receive rewards for helping Scholars persist and complete, tracking Scholar outcomes compared

with other similar students, and adopting evidence-based strategies for increasing Scholar persistence and completion.

While our reform options rely on working within existing federal and state data infrastructure,

the same goals could be reached through the establishment of a national student unit record system or, to some extent, through partnerships with a private intermediary, such as the National Student Clearinghouse.



# I. Reforming Student Aid to Better Meet Student and Parent Needs



Postsecondary education is increasingly important for individual, community, and national economic success. However, it is quickly slipping out of reach for millions of low- and modest-income families as rapidly growing college costs outpace their ability to pay. This trend reduces postsecondary access for financially vulnerable students, fuels rising student debt, and undermines persistence and completion. Student aid reform should increase affordability, promote innovation to address other obstacles to completion, and provide better information to students and parents for making college choices. Tax-based student aid in particular merits much more scrutiny by policymakers because it has grown rapidly and disproportionately benefits higher-income families (see Figures 5 and 6 in Section II).

## Twin Challenges: Affordability and Completion

Historically, higher education has been associated with higher earnings and lower rates of unemployment. For example, in 2011, associate's degree holders earned about 20 percent more than high school graduates with no college and 70 percent more than workers with less than a high school diploma. Having a postsecondary education also provides protection against unemployment. In 2011, the unemployment rate was 4.9 percent for individuals with a bachelor's degree compared with 6.8 percent for those with an associate's degree and 9.4 percent for high school graduates with no college. Workers with less than a high school diploma were twice as

likely to be unemployed as those with an associate's degree (U.S. Bureau of Labor Statistics 2012).

In today's economy, postsecondary education has increasingly become a gatekeeper for entry to the middle class, according to a 2010 analysis by the Georgetown University Center on Education and the Workforce. Over the last three decades, Americans with a high school education or less have become much less likely to be in the middle class or in upper-income groups; many more are now concentrated in the lower 30 percent of the income spectrum. Conversely, the percentages of people with postsecondary education—especially bachelor's degrees and above—who are in the middle class or higher has increased (Carnevale, Smith, and Strohl 2010).

Not only has postsecondary education become increasingly important for individual economic well-being, it is also important for our national and local economic competitiveness. Employer demand nationally for workers with at least some postsecondary education more than doubled between 1973 and 2007, from 28 percent of all jobs to 59 percent (Carnevale, Smith, and Strohl 2010). At the regional level, a recent Brookings Institution study of metropolitan labor markets finds that high “educational attainment makes workers more employable, creates demand for complementary less educated workers, and facilitates entrepreneurship” (Rothwell 2012). And despite current high unemployment, economists generally predict that demand for workers with some postsecondary education will continue to grow over the long term, though they disagree on the magnitude of that trend (Neumark, Johnson, and Cuellar Mejia 2011).

### COLLEGE COSTS ARE GROWING FAR FASTER THAN FAMILY INCOMES, DRIVEN IN PART BY DECLINING STATE AND LOCAL FUNDING FOR HIGHER EDUCATION.

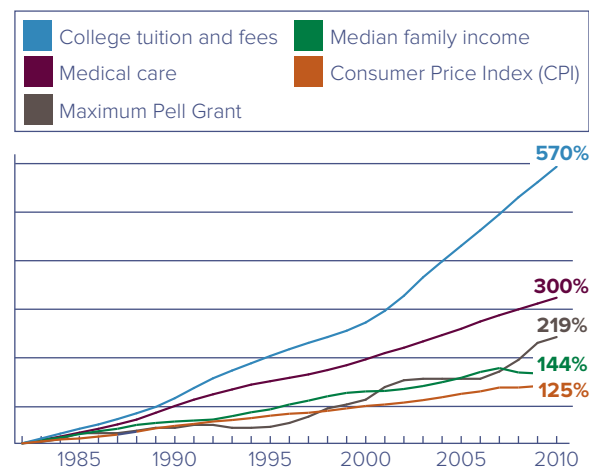
Over the last three decades, college costs have increased nearly four times faster than median family income (*Figure 1*, Harvey 2012). This growth contrasts with shrinking public resources for higher

education. State and local appropriations for higher education have declined significantly between 2000 and 2010—by 24 percent in research universities and in master's institutions and by 20 percent in bachelor's colleges and in community colleges.

At community colleges, total operating revenues *per student* declined by 7 percent from 2009 to 2010, and this sector was the only one among public higher education institutions in which total operating revenues per student were lower than they were a decade earlier. This is due to very high growth in enrollments (9 percent increase from 2009 to 2010) combined with revenue declines (Kirshstein and Hurlburt 2012). Combined state and local support per student for all of higher education (excluding appropriations for research, agricultural extension, and medical education) fell to a 25-year low in 2010, and then declined nearly 4 percent more in

**Figure 1: College Costs Rising Four Times Faster Than Income, Two and a Half Times Faster Than Pell Grants**

Rate of cost growth in higher education and other goods compared to growth in Pell Grants, 1982-2011



**Source:** Darcie Harvey (National Center for Public Policy and Higher Education) and CLASP analysis based on data from the Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers. Median family income is from U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements and the American Community Survey. Maximum Pell Grant from Department of Education, Pell Grant End-of-Year Report (2010-2011). Adapted from figure in *Lifting the Fog on Inequitable Financial Aid Policies*, Lynch, Engle, and Cruz (2011).



*Half of community college students had unmet financial need in 2007-08 as did 43 percent of students at public four year colleges.*

2011 (State Higher Education Executive Officers 2012). This decrease in funding for public higher education institutions explains much of the recent rise in the tuition and fees they charge (Desrochers and Wellman 2009).

Additionally, state aid for students has been essentially flat funded. When the National Association of State Student Grant and Aid Programs recently surveyed its members, it found that state need-based aid for undergraduates increased just 1.7 percent, from \$6.3 billion in 2009-10 to \$6.4 billion in 2010-11 (NASSGAP 2012). And both states and postsecondary institutions have been shifting away from aid to students based on financial need to aid based on nonfinancial factors, further reducing potential resources to help low- and modest-income students (Woo and Choy 2011). While aid based on need accounted for 90 percent of state grant aid in 1982-83, that share had fallen to 71 percent by 2010-11 (Baum and Ma 2012).

While the federal government substantially increased the maximum Pell Grant in recent years to respond to rising college costs, simultaneous growth in college enrollments during the recession strained the program's budget and ultimately led to cuts in Pell eligibility. Pell Grant spending has leveled off as the economy recovers: college enrollments declined in fall 2011 (Knapp, Kelly-Reid, and Ginder 2012) and early indications are that they fell again in fall 2012 (National Student Clearinghouse, 2012). Nevertheless, over the long term, Pell Grant funding remains threatened by further cuts with the ending of one revenue source for it, creating

a funding gap beginning in fiscal year 2015 (FY 2015). (Delisle, 2013)

**HIGH UNMET NEED MAKES COLLEGE A RISKIER INVESTMENT FOR STUDENTS AND FAMILIES.**

All of this eroding support translates into higher college costs for low- and modest-income students even after taking into account “net price”—that is, after adjusting for any financial aid (including tax-based student aid) they receive. According to U.S. Department of Education data, net price increased steadily and dramatically between 1995-96 and 2007-08—by 77 percent for community college students and by 62 percent for students at public four-year institutions. Among all undergraduates, net price increased by 66 percent for dependent students and by 96 percent for independent students.<sup>1</sup> Not surprisingly, “unmet financial need”—the share of college costs not covered by financial aid, tax-based student aid, or the expected family contribution—also rose sharply during this period, from \$3,000 to \$4,500 for community college students with unmet need and from \$3,900 to \$6,400 for those with unmet need attending public four-year institutions. Half of community college students had unmet financial need in 2007-08, as did 43 percent of students at public four-year colleges (National Center for Education Statistics 2011).

Confronted with such costs, low- and modest-income students and their families face a difficult choice: work more while in college, borrow more, or do both. Students are working more, with negative consequences for their ability to complete college, as discussed below. They are also borrowing more. Two-thirds of students graduating from four-year colleges borrow to pay for their education; their average cumulative debt is \$26,600.

<sup>1</sup> Authors' calculations based on data in table 3.1 in the report, *Trends in Student Financing of Undergraduate Education: Selected Years, 1995-96 to 2007-08* from the U.S. Department of Education, NCES 2011-218, January 2011.

Low-income students are especially affected: Pell Grant recipients are twice as likely to borrow as other students (Reed and Cochrane 2012).

While just one in ten community college students takes out a student loan, the proportion more than doubled—from 4.3 percent to 10.2 percent—between 1995-96 and 2007-08, and it likely has risen further since then (National Center for Education Statistics 2010). Recent interviews of community college students by CLASP found that they are very loan averse for a variety of reasons. One student was planning to transfer to a four-year institution to earn a degree in social work. Knowing she would need loans to pay for the higher tuition in her third and fourth years, she chose to avoid them in her first two years, at the community college. She also was keenly aware that she would not earn much as a social worker and wanted to avoid as much debt as possible. Another student who was entering college for the first time in her 50s astutely noted, “In my situation, I have to look at loans differently. [I] don’t have those 20 to 30 years to pay [back] loans.” Instead, she balances school with a 20-hour work-study job and took funds from her retirement savings to help pay for her first year of study toward an accounting degree.<sup>2</sup>

Higher unmet financial need, the resulting pressure to work more and borrow more, and high unemployment among recent college graduates all combine to make postsecondary education a riskier proposition than before, at least in the near term. Students can reduce that risk by choosing carefully among college majors and occupational programs, because employment and earnings outcomes after graduation vary substantially depending on the field of study (Carnevale, Cheah, and Strohl 2012; Zaback, Carlson, and Crellin 2012). Ideally, students could also shop around for the institutions offering programs of interest that offer the best value, in terms of program costs, completion rates, and labor market (or further education) outcomes.

<sup>2</sup> Interviews with students at South Central College, North Mankato campus (Minnesota) by CLASP, November 9, 2012.

Unfortunately, as we discuss in Section III, this critical information is not available to them.

### FINANCIAL PRESSURES DRIVE DOWN COLLEGE COMPLETION.

Lack of affordability not only limits access to college, it also affects time to a degree and whether students ultimately complete a credential. For example, about 66 percent of young community college students work more than 20 hours per week to cover college and family costs, and 58 percent attend college part-time to accommodate work (Orozco and Cauthen 2009). The need to work substantially while in college may explain the widespread prevalence of part-time college attendance. A recent study by the National Student Clearinghouse of nearly two million undergraduates found that more than half (51 percent) attended a mix of full and part-time over a six-year period (Shapiro et al. 2012).

Not being able to attend full-time lengthens the time students need to complete. After examining other possible reasons, John Bound, Michael Lovenheim, and Sarah Turner (2010) conclude that increased work by undergraduates likely explains most of the large increase in time to a degree observed over the past three decades. They note that time to degree increased substantially while public higher education resources were declining, family incomes were eroding relative to college costs, and students were working more hours, with low-income students at public institutions affected most. National Student Clearinghouse data reflect this longer timeframe needed to complete a college credential. After six years, 76 percent of full-time students had completed, with just 4 percent still enrolled. By contrast, among students attending a mix of full and part-time, 41 percent had completed and 27 percent were still enrolled. The report notes that one implication for public policymakers is they should “raise institutions’ accountability for retaining and graduating part-time and mixed enrollment students as well as adult learners, given the distinctive nature and pathways of these groups of students” (Shapiro et al. 2012).



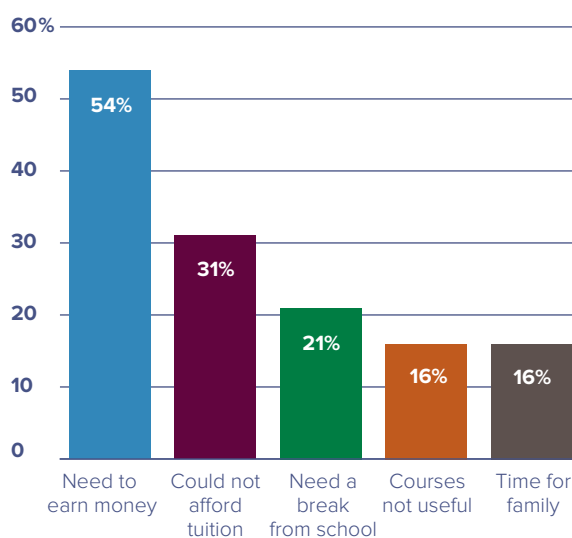
Beyond increasing time to a degree, financial pressure to work more while in college—and consequently take fewer classes at a time—also affects completion. Though students fail to complete postsecondary programs for a variety of reasons, financial pressures appear to be the single largest factor. A number of studies have found that working too many hours while in college negatively affects academic performance (Scott-Clayton 2012). A 2009 survey of young adults who had left college is consistent with this: 71 percent of students who had left school said one reason was because they had to “go to work and make money;” 54 percent listed this as a “major reason” (Johnson and Rochkind 2009) (*Figure 2*). Fifty-eight percent of those who had left school received no financial help from their parents or other relatives (compared with 37 percent of students who graduated), and 69 percent did not receive scholarships or financial aid (compared with 43 percent of students who graduated). According to the survey, “More than a third (36 percent) of those who left school say that even if they had a grant that fully paid for tuition and books, it would be hard to go back” because they have to work full-time and have family commitments.

Given these financial issues, it is not surprising that need-based grant aid not only increases college enrollment among low- and modest-income students but can also increase persistence and credits earned (Castleman and Long October 2012; Goldrick-Rab et al. 2012).<sup>3</sup> But other factors can also stand in the way of student success. A 2011 Community College Research Center series reviewing the evidence on community college reform notes that these factors include logistical barriers (e.g., child care, transportation), poor high school academic preparation for college, and lack of knowledge about navigating complex college academic and financial processes (Bailey, Smith Jagers, and Jenkins 2011).

3 Other research on this point includes: Lovenheim and Owens (2013), Bettinger (2004), Kane (2003), Brinkman and Leslie (1988), as cited in Heller (1997), Dynarski (2003), and Seftor and Turner, (2002).

**FIGURE 2: Needing to Work Is Top Reason Students Leave College Early, Not Being Able to Afford Tuition is Second**

Share stating the following is a major reason they left school



**Notes:** Survey respondents were 22- to 30-year-old students who did not complete their postsecondary education.

**Source:** CLASP, based on data from, *With Their Whole Lives Ahead of Them: Myths and Realities About Why So Many Students Fail to Finish College*, Johnson and Rochkind (2009).

The same review series identifies some promising reforms beyond financial aid for improving community college completion rates. These include new approaches to improving remediation (e.g., acceleration, contextualization), ways to create more-structured college experiences, the importance of helping students enter programs of study quickly, and mechanisms for better supporting student success.

Perhaps the biggest lesson from that research review is that reforms to increase student completion are more powerful when combined with one another and when connected to broad-based institutional change that engages college faculty and staff (Bailey 2012; Jenkins 2011). Such organizational reform is larger than any one programmatic innovation, and it depends in part on institutions’ using data to examine and improve student outcomes.

Some financial aid programs have coupled grant aid with other interventions, such as innovations in course delivery, curriculum or instruction, learning communities, financial incentives, extra academic support and advising, and emergency transportation or child care aid. These multifaceted approaches may be even more effective than grant aid alone (Scrivener, Weiss and Sommo, 2012; Deming and Dynarski, 2009; Washington State Board for Community and Technical Colleges, 2011).

## CLASP's Guiding Principles for Reforming Federal Student Aid

If rising costs relative to family incomes are making college a riskier investment for students and families—and harming completion rates—then federal student aid policy should reduce that risk by making college more affordable for low- and modest-income families, as well as by giving families much better tools for determining which postsecondary education programs are worth their substantial investments of time and money. In addition, federal programs should give policymakers and institutions better data for improving policy and practice, and they should create partnerships among the federal government, states, and institutions to address the affordability challenge and other issues that reduce completion.

CLASP recognizes that changes to federal student aid should not be proposed lightly, especially at a time when federal policymakers are focused on budget austerity rather than on the nation's linked affordability and completion challenges. Moreover, given the fiscal issues confronting the federal government, it is likely that the funding for these important tasks will have to be found within existing federal spending.

Accordingly, we have developed principles for guiding student aid reform choices.

First, we believe the goal of federal higher education policy should be to increase educational and economic opportunity for all students, with a priority

on low-income underrepresented populations who could not access and afford postsecondary education without federal assistance.

Second, federal student financial aid reforms should preserve—and even enhance—the original purpose of these programs: to increase access. Student success and completion are worthy additions but should be pursued in ways that do not undermine access.

Third, any reforms should make federal student aid:

- *More effective*, in terms of increasing access and completion by low-income, underrepresented populations,
- *More efficient*, in terms of maximizing the impact of limited federal dollars, and
- *Simpler* for students and their families to understand and use.

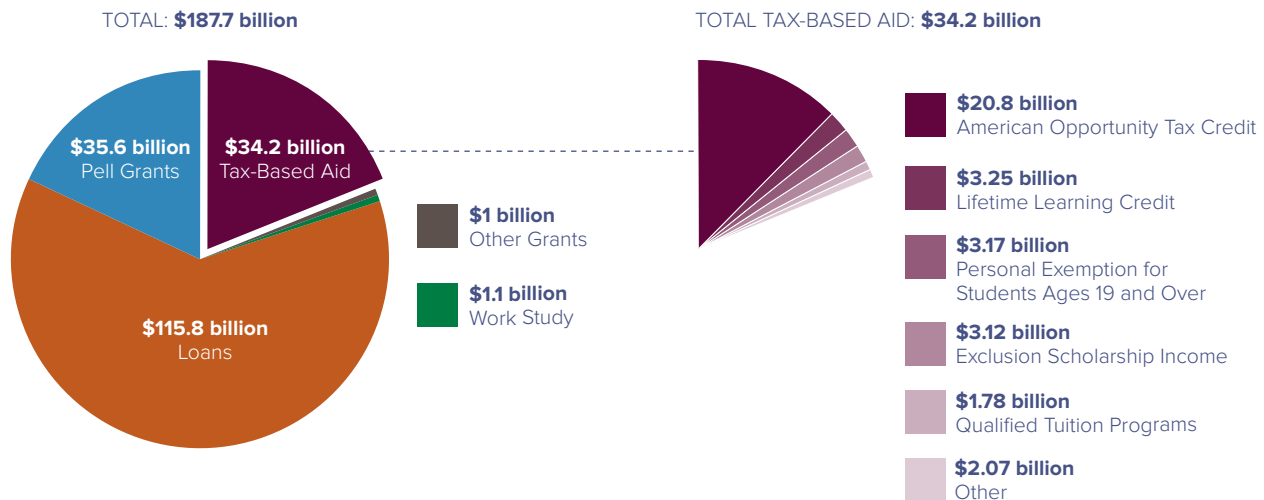
Fourth, in looking forward, CLASP strongly believes that all policy reform proposals must pass a high bar before being moved forward for legislative or executive branch action. In our view, reform proposals should be *evidence-based*, with data backing the need for change as well as data showing that proposed changes will help, not hurt, needy students; *modeled*, to clearly show any redistributive effects among students and families; and *piloted*, to understand the actual effects on students and institutions before major changes are scaled up.

Based on these considerations, CLASP has focused its RADD work on two federal policy areas that have received relatively little attention and where we see considerable room for improvement: tax-based student aid and higher education performance metrics. Our options for federal student aid reform strive to:

- Make tax-based student aid simpler and more effective in increasing access and completion,
- Provide students, parents, policymakers, and colleges with the facts needed to guide their decisions and improve policy and practice, and
- Create incentives for students and colleges to

**FIGURE 3: Tax-Based Aid Accounts for Nearly Half of Non-Loan Federal Aid**

Federal student aid by type in billions, FY 2012



**Notes:** “Other” includes the student loan interest deduction, the tuition and fees deduction, and the exclusion for employer-provided educational assistance.

**Source:** CLASP, based on data from the Department of Education and the President’s FY 2013 budget.

partner with the federal government on college completion.

We have chosen not to focus on the Pell Grant program in our reform options for several reasons. First, the Pell Grant program already has been cut by an estimated \$56 billion over the next ten years and is failing to keep up with financial need.<sup>4</sup> In the 1980s, the maximum Pell Grant covered more than half the cost of attending a four-year public college. Next year’s \$5,635 maximum Pell Grant will cover less than one-third of the cost of college—the lowest since the start of the program.<sup>5</sup> Second, there is no compelling fiscal case for cutting Pell Grants further. As noted, growth in Pell Grant costs has leveled off. And FY 2013, the program is running a cumulative surplus of over \$9 billion (Delisle 2013). The funding gap that opens

up in the Pell Grant program beginning in FY 2015 is due to an existing revenue source ending, not to unsustainable growth.<sup>6</sup>

Congress should look for savings elsewhere in student aid to fill that gap. Tax-based aid, for example, now accounts for nearly half of non-loan federal aid and substantially benefits upper-income households (*Figure 3*). By contrast, Pell Grants are very well targeted to low- and modest-income students, who have been most affected by rising college costs. Further, recent eligibility cuts in the Pell Grant program have been made in the context of congressional budget debates, with little consideration of the impact, let alone evidence they were necessary. Some of those changes have eliminated grants to whole groups of students who were previously eligible, such as those who had received Pell Grants for more than 12 semesters, even if they were nearly finished with college.

4 Calculations by Center on Budget and Policy Priorities on data from the Congressional Budget Office, March 2011 baseline and estimates of changes made in 2011.

5 Calculations by the Institute for College Access and Success with data from the College Board, *Trends in College Pricing 2011*, Table 5a and FinAid.org, Pell Historical Figures .

6 See Kogan and Merrick, April 26, 2012, for an explanation and estimate of the funding gap calculated from CBO March 2012 data. For latest estimate of that gap over ten years, see Delisle, 2013.

Another group that lost eligibility is students without a high school diploma or the equivalent (such as the GED) who are able to prove their ability to benefit from college through one of several federally defined options.<sup>7</sup> That change has seriously undermined innovative adult career pathway programs that make postsecondary education accessible for low-skilled adults and youth who lack a high school diploma.

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7 Previously, these students could qualify for student aid by either passing a federally approved test or passing six credit hours. Also, states could specify a process for determining students' ability to benefit. All of these options were cut, generating only small budget savings in 2012 but effectively closing the door to college for thousands. See "Eliminating 'Ability to Benefit' Student Aid Options Closes Door to College Credentials for Thousands and Undermines Innovation," CLASP factsheet, accessed at <http://www.clasp.org/admin/site/documents/files/CLASP-AtB-one-pager.pdf>.



## II. Making Tax-Based Student Aid Simpler and More Effective



Current federal tax-based student aid can be divided into three categories:

- Provisions that reduce the financial burdens of college while a student is still enrolled or shortly thereafter,
- Incentives that encourage families to save for future college expenses, and
- Benefits that reduce the financial hardship resulting from previous college expenses.

The first category includes the two higher education tax credits—the American Opportunity

Tax Credit and the Lifetime Learning Credit—as well as the multiple deductions and exclusions available to those with qualifying higher education expenses.

The AOTC, created under the American Recovery and Reinvestment Act of 2009 to replace the former Hope Credit, is partially refundable (40 percent), provides up to \$2,500 in value, and is available for the first four years of postsecondary education to students attending at least half time. The credit and its parameters are not adjusted for inflation. In contrast, the Hope Credit was adjusted for inflation but has not been in effect since 2008.

For more information on the Hope and American Opportunity Tax Credits, refer to Table 1.

The Lifetime Learning Credit is equal to 20 percent of a taxpayer's first \$10,000 of qualified expenses up to \$2,000. It has no time limit on the number of years the credit can be claimed and is available to

all students, including those attending less than half time and in graduate school. The LLC and its phase-out levels are adjusted for inflation.

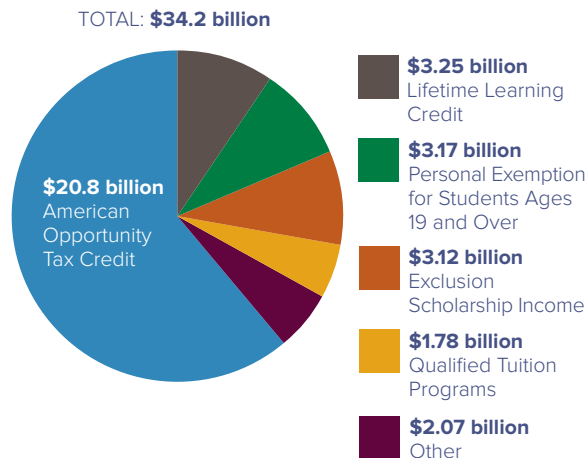
In 2009, 9.1 million households claimed the AOTC and 3.4 million households claimed the LLC, totaling \$16 billion and \$2.4 billion in benefits,

**TABLE 1: Main Features of the American Opportunity Tax Credit and the Hope Credit**

	AOTC (2009-2017)	Hope Credit (2008)
<b>Maximum Credit Value</b>	\$2,500 <i>100 percent of the first \$2,000 of qualifying expenses, plus 25 percent of the next \$2,000 in qualifying expenses</i>	\$1,800* <i>100 percent of the first \$1,200 of qualifying expenses, plus 50 percent of the next \$1,200 in qualifying expenses*</i>
<b>Refundability</b>	40 percent refundable; maximum cash refund of \$1,000	Nonrefundable
<b>Income Phase-Out</b>	Single and Head of Household: \$80,000-\$90,000  Married Filing Jointly: \$160,000-\$180,000	Single and Head of Household: \$48,000-\$58,000*  Married Filing Jointly: \$96,000-\$116,000*
<b>Qualifying Expenses</b>	Tuition, fees, and required course materials	Tuition and fees
<b>Miscellaneous</b>	The credit is available for the first four years of postsecondary education (including any years the Hope Credit was claimed).  Students must be enrolled at least half time for at least one academic period that begins during the tax year, and they must be working toward an undergraduate degree, certificate, or other recognized education credential.	The credit is available for the first two years of postsecondary education.  Students must be enrolled at least half time for at least one academic period that begins during the tax year, and they must be working toward an undergraduate degree, certificate, or other recognized education credential.

\* The parameters correspond to 2008 levels. If the AOTC expires at the end of 2017 and the law reverts to the Hope Credit, these amounts will be adjusted for inflation. The base level of qualified expenses is \$1,000; the base phase-out levels are \$40,000-\$50,000 (single and head-of-household), and \$80,000-\$100,000 (married filing jointly). Each year, the IRS adjusts the parameters from these base levels.

**FIGURE 4: Federal Tax-Based Student Aid, FY 2012**



**Notes:** "Other" includes the student loan interest deduction, the tuition and fees deduction, and the exclusion for employer-provided educational assistance.

**Source:** CLASP, based on estimates from President's FY 2013 Budget.

respectively (White and Scott May 2012).<sup>8</sup>

The first category of tax-based student aid, *provisions that reduce the financial burdens of college while a student is still enrolled or shortly thereafter*, includes some higher education-related tax deductions, exclusions, and exemptions: the tuition and fees deduction, the exclusion of scholarship and fellowship income, the personal exemption for dependent students ages 19-23, and the exclusion for employer-provided educational assistance. In 2009, 1.7 million tax filers claimed the tuition and fees deduction, reducing federal revenues by \$628.9 million (White and Scott May 2012).

The second category, *incentives to encourage saving for future higher education expenses*, includes qualified tuition programs (also known as

8 The figure of \$16 billion includes both the refundable and nonrefundable portions. White and Scott (2012) do not divide the total amount into the share that offsets tax liability (the nonrefundable portion) and the amount received as a cash refund (the refundable portion). According to Crandall-Hollick (2012), the nonrefundable credit reduced federal revenues by \$12.26 billion in 2009, and the refundable amount increased outlays by \$3.89 billion in the same year, for a total cost of \$16.26 billion (numbers are not equal due rounding error).

529 programs) and Coverdell Education Savings Accounts. In 2006, 4.2 million households held either a 529 plan or a Coverdell ESA (White and Scott May 2012). Other provisions in this category include the exclusion for savings bond interest, the exclusion for early IRA withdrawals spent on educational expenses, and the gift tax exclusion allowed for tuition payments by a donor on behalf of a student.

The third and final category, *benefits that reduce future financial hardship resulting from previous higher education expenses*, includes the student loan interest deduction as well as the student loan forgiveness program. The student loan interest deduction allows individuals to exclude from their taxable income any student loan interest paid during the tax year. Loans made and forgiven by the government are usually included in the taxpayer's income for tax purposes. However, individuals who work for a certain class of employers can exclude the forgiven sum in estimating tax liability.<sup>9</sup>

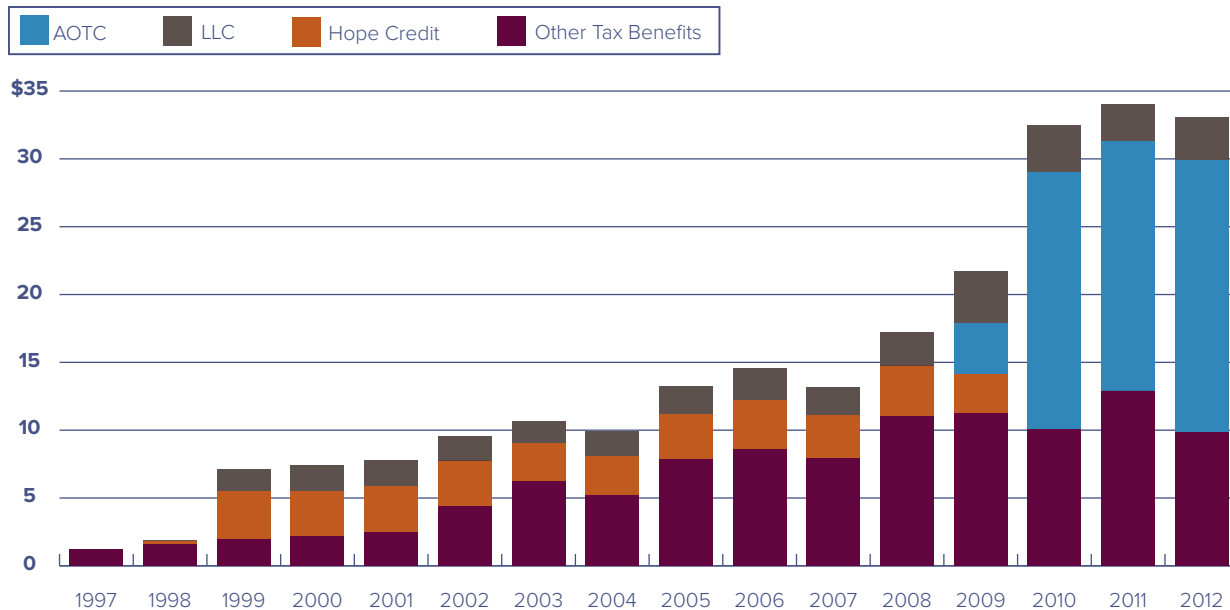
9 This includes Public Service Loan Forgiveness (Section 455(m)(2) of the Higher Education Act of 1965) and Teacher Loan Forgiveness (Sections 460 and 428J of the Higher Education Act of 1965).





**FIGURE 5: Historical Spending on Tax-Based Student Aid**

In billions, FY 1997-FY 2012 (in 2010 dollars)



**Notes:** Figures are in constant dollars (2010). “Other tax benefits” includes other postsecondary education tax benefits, such as the student loan interest deduction, the tuition and fees deduction, employer-provided educational assistance, and others.

**Source:** CLASP, based on data from the Office of Management and Budget.

## Why Reform Tax-Based Student Aid?

As federal tax-based student aid has increased (*Figure 5*), so too has criticism of it. The three primary concerns about tax-based student aid are that: it provides little benefit to the lowest-income students, it does not increase college access or completion, and it is too complex and difficult to use.

### TAX-BASED AID PROVIDES LITTLE BENEFIT TO THE LOWEST-INCOME STUDENTS.

To a significant degree, this problem is inherent in tax deductions and credits. *Deductions* indirectly reduce a household’s tax liability by allowing the household to deduct certain expenses from its taxable income. The value of a deduction depends on one’s marginal tax rate. In a progressive tax system, like that of the United States, generally the marginal tax rate of a household increases along with its income (Tax Policy

Center 2011). Thus, a \$100 deduction is worth \$39.60 to a high-income household facing a 39.6 percent marginal tax rate (the current top rate in the United States) but only \$10 to a modest-income family facing a 10 percent marginal tax rate. It is of no value to a family that has no income tax liability.

*Tax credits*, by contrast, directly reduce a filer’s tax liability. Thus, a \$100 credit is equally valuable to taxpayers at different marginal tax rates. However, unless a credit is refundable, it is of no value to households without any income tax liability. Recognizing this limitation, policymakers have made some tax credits *refundable*. When credits are refundable, households whose credit values exceed their tax liability may receive the difference as a full or partial cash refund.<sup>10</sup> This is of significant value to

<sup>10</sup> For more information on how exemptions, deductions, and credits reduce tax liability, see the Center on Budget and Policy Priorities’ *Policy Basics: Tax Exemptions, Deductions, and Credits*.

low-income families who, on average, tend to pay less income tax. Of the major higher education tax credits, only the AOTC is *partially* refundable. The Lifetime Learning Credit is nonrefundable, as was the Hope Credit.

**TAX-BASED AID DOES LITTLE TO INCENTIVIZE COLLEGE ENROLLMENT AND COMPLETION.<sup>11</sup>**

Tax-based student aid provides substantial support to individuals who are already highly likely to attend college (*Figure 6*). In 2009, 20 percent of AOTC and LLC benefits went to households earning more than \$100,000 per year; more than half of the benefits of the tuition and fees deduction and of the parental exemption for college students

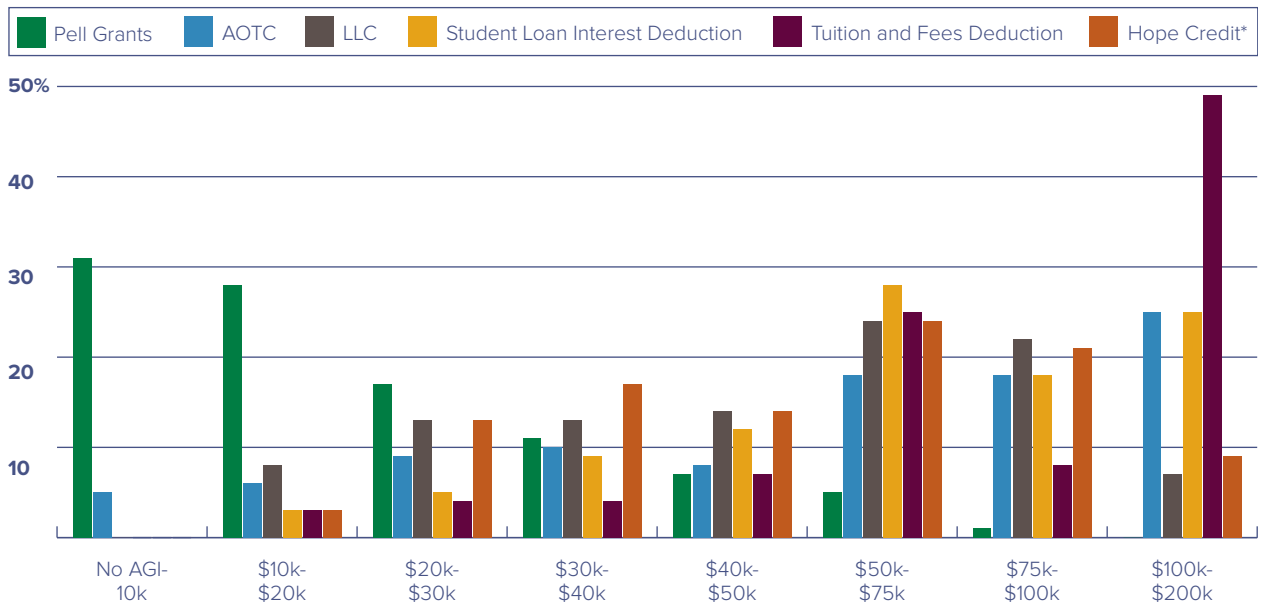
went to households earning more than \$100,000 per year (White and Scott May 2012). According to the National Center for Education Statistics, in 2010, the immediate college enrollment rate—the percentage of high school completers of a given year who enroll in two- or four-year colleges in the fall immediately after completing high school—was 52 percent for low-income families (bottom 20 percent), 67 percent for middle-income families (middle 60 percent), and 82 percent for high-income families (top 20 percent, approximately \$100,000 for all tax units). (National Center for Education Statistics 2010)

Timing and lack of knowledge also undermine the extent to which tax-based student aid can incentivize behavior. Tax-based student aid rewards behavior after it takes place—up to 16 months later in the case of higher education tax credits. The separation between action and benefit weakens the ability of an incentive to encourage action. Moreover, students may not even realize a benefit is available until filing

11 While tax-based student aid has little effect on access to college, it is important to note that it may influence college choice among those who already intend to enroll. Guzman (2013) finds tax-based aid does affect choice in some unexpected ways; more research is needed on this topic as few studies have examined it.

**FIGURE 6: Distribution of Major Tax-Based Student Aid and Pell Grants**

Percent distribution of student aid by type and income category in 2013



**Notes:** \*Provision is not currently in effect.

**Source:** CLASP, based on data from the Tax Policy Center.

their taxes, if at all. According to Suzanne Mettler (2010), almost 60 percent of individuals who claim a higher education tax credit do not realize they have received help from the government to pay for college. The separation between action and benefit also requires the student, whether through loans or savings, to cover all the expenses at the time of enrollment, when financial need is likely at its highest. Therefore, while the benefit reduces financial hardship on the backend, it does not reduce the cost of attendance: a student will have to find some form of support, whether through savings, loans, or gifts, to make up that difference at the time of enrollment.

Research on whether tax-based student aid increases enrollment is mixed. Earlier research found no effect of tax-based aid on college enrollment (Long 2004); more recent research found such aid did increase enrollment among some subgroups but not others (Turner September 2011; LaLumia 2012). Even fewer studies have examined the impact of tax-based aid on persistence and completion, with Turner finding it does increase persistence into the second year of college and LaLumia finding it does not increase degree completion. Because none of the studies to date include the AOTC, which greatly expanded tuition tax credits (see Table 1), the impact of those changes on the effectiveness of this type of aid is unknown. Even if tax-based student aid does increase enrollment, it still faces an efficiency problem: as currently structured, federal tax-based aid subsidizes many students who would have gone to college without that aid in order to influence the enrollment decisions of the few students for whom the tax-based aid makes a difference. Turner, for example, finds that for each student prompted by tax-based aid to enroll (or, possibly, to switch from part-time to full-time enrollment) as many as 13 other students receive college subsidies without that aid changing their enrollment decisions.

### THE SYSTEM OF TAX-BASED AID IS COMPLEX AND DIFFICULT TO USE.

Student aid provisions in the tax code are numerous and include multiple tax credits, a variety of

deductions, and numerous exclusions. These benefits are not independent of one another; that is, utilization of one influences eligibility for another. Susan Dynarski (2004) found that education savings vehicles actually can leave a family that is on the margin of receiving financial aid worse off because the increase in financial assets may substantially decrease aid eligibility. Furthermore, unlike grants and loans, accessing tax-based aid requires a certain degree of student management throughout the year: each student must track expenses over the course of two academic years to calculate aid accurately.

In addition to understanding what is available, a student must also be able to weigh the various tax-based aid options. Deciding among these options is not easy and often results in students' making less-than-optimal decisions. The GAO recently looked at this issue for taxpayers who are eligible for either the tuition and fees deduction or the Lifetime Learning Credit. Of the 11 million filers eligible to claim either in 2009, only 14 percent, or about 1.5 million households, failed to do so. Among households that did claim a benefit, however, many made a suboptimal choice. For example, 40 percent of those who claimed the tuition deduction in 2009 would have increased their tax benefit by claiming the Lifetime Learning Credit instead.<sup>12</sup>

## How to Reform Tax-Based Student Aid

CLASP considered a range of possible reforms to the current set of tax-based student aid policies and contracted with the Tax Policy Center to model the costs and distributional effects of many alternatives. What follows are the most promising approaches based on how well they meet our design

<sup>12</sup> Among filers who appeared to make a suboptimal choice at the federal level by claiming the tuition deduction (i.e., they claimed the tuition deduction but would have maximized their federal tax benefit by claiming the LLC), about one-third (about 79,000 of 237,000 filers) actually maximized their combined federal and state tax benefit by selecting the tuition deduction, even though their federal income tax was higher.

criteria of improving efficiency, effectiveness, and simplicity in federal student aid policy, as well as our overarching goal of using federal student aid to increase educational and economic opportunity for all students, with a priority for low-income, underrepresented populations. We also took into account the need to provide some relief to modest-income families from the financial hardship imposed by college expenses, and we paid close attention to the likely cost of our reform options, striving to keep our reforms roughly budget neutral with respect to current policy.<sup>13</sup>

The first set of reform options, *improvements to the American Opportunity Tax Credit*, increase the value of the AOTC to low-income students, which in turn makes college more affordable, and thereby supports persistence and completion. It also makes more efficient use of scarce federal resources by minimizing the extent to which federal tax-based student aid merely provides a windfall to those who would have attended and completed college without federal help. At the same time, these options preserve tax relief for modest-income families and reduce financial hardship due to college expenses. (Box 1 explores similar types of improvements to the Hope Credit, in the event that the AOTC is allowed to expire at the end of 2017.)

The second set of reforms, *ways to simplify and better target tax-based student aid*, provides budgetary flexibility to support the reform options in the first section and improves the design of tax-based aid to increase its effectiveness and efficiency.

A third set of reforms, *outreach and delivery improvements*, presents cost-neutral and low-cost

ways to improve the delivery of higher education tax credits to make them more accessible, visible, and timely for beneficiaries and to link tax credits more closely to other forms of student aid.

We then show how the first two sets of reform options might be packaged in different ways to further the goal of increasing access and completion, especially for low-income students. While we focus on improving federal tax-based student aid, we also show how that might be accomplished while at the same time freeing up enough federal revenues to help stabilize Pell Grant funding and for student aid innovation. Taken together, these options address the major criticisms of tax-based student aid policy, and they do so in a fiscally responsible way.

While we think such reforms would result in more-effective higher education tax policies, we view them as a “second best” strategy, given the inherent challenges of delivering student aid through the tax system. For the reasons described in Section I, the ideal solution would be to take the federal resources currently devoted to tax-based student aid and reinvest them in Pell Grants, which would help close the affordability gap, and in innovation to improve outcomes, such as the Compact for College Completion described in Section III. However, because federal budget and political realities make this very difficult, tax-based aid is likely to continue as a large portion of federal student aid spending.

## IMPROVE THE AMERICAN OPPORTUNITY TAX CREDIT.

The maximum value of the nonrefundable and refundable portions of the AOTC are \$2,500 and \$1,000, respectively. The first \$2,000 of the nonrefundable credit is awarded on a dollar-for-dollar basis; that is, for every dollar of Qualified Tuition and Related Expenses paid by the household, its tax liability is reduced by one dollar, up to \$2,000. After \$2,000, for every four dollars of qualified expenses, a taxpayer’s liability is reduced by one dollar, up to

<sup>13</sup> The Tax Policy Center’s *current policy* baseline assumes that all federal policies currently in effect remain in effect. The passage of the American Taxpayer Relief Act of 2012 made permanent many of the features of the current policy baseline, narrowing the difference between the *current law* and *current policy* baselines. The key difference between the policy and current law baselines for this project is that the current policy baseline extends the AOTC and tuition and fees deduction for the entire budget window, while current law has the tuition and fees deduction expiring at the end of 2013 and the AOTC expiring at the end of 2017.

\$500. If an eligible tax unit has zero tax liability, it can receive 40 percent of the balance of the credit value as a cash refund, up to \$1,000.

**OPTION 1:** Expand qualified expenses to reflect more of the actual cost of attendance.

**DESCRIPTION:** Option 1 aligns the definition of qualified expenses under the AOTC with that of cost of attendance under Title IV student aid programs. The American Opportunity Tax Credit defines qualified tuition and related expenses as “tuition and certain related expenses required for enrollment or attendance at an eligible educational institution.” “Certain related expenses” includes required course materials (e.g., books, lab items) and mandatory fees.<sup>14</sup> By contrast, the Department of Education calculates financial need for student grant and loan programs based on estimated “cost of attendance,” which includes tuition and fees, room and board, required equipment, supplies and materials, transportation, dependent care expenses, disability-related expenses, and loan fees.<sup>15</sup> 529 and Coverdell ESAs also use a broad definition of qualified expenses that closely resembles the Title IV definition.

**DISCUSSION:** The definition of qualified expenses for purposes of claiming the AOTC does not represent accurately the costs a student incurs to enroll in postsecondary education. Students must still pay for room and board, supplies and materials, and transportation, as well as child care in some cases.

The narrow definition of qualified expenses is especially problematic for low-income students, who disproportionately attend low-cost institutions. The average level of in-state tuition and fees at two-year public institutions was \$3,131 for the 2012-13 academic year, almost \$1,000 less than the \$4,000 in qualifying expenses necessary to receive the maximum AOTC award and less than 30 percent of

the total cost of tuition, fees, and room and board (College Board 2012). Thus, the typical student at a two-year public college would be eligible to receive a maximum AOTC of \$2,282.<sup>16</sup>

While this level appears close to the maximum award available, \$2,500, there is reason to believe that it is much lower in practice. First, there is a “stacking” issue. Grants—including Pell Grants—and other aid are traditionally applied to tuition and fees before other expenses, reducing the total amount of eligible expenses a student could use to claim the AOTC. When combined with the AOTC’s narrow definition of qualified expenses, this practice can dramatically reduce or eliminate a student’s AOTC award. Changing the stacking order could address this problem, but there is second issue. Low-income students with little tax liability will have to use the refundable credit; because the AOTC is only 40 percent refundable, these students can only receive 40 percent of the value of whatever credit they are eligible for. For example, the two-year college student described above would receive only \$913 of the \$2,282 she otherwise qualifies for (40 percent of \$2,282).

**ESTIMATED IMPACT ON DISTRIBUTION OF AID:**

Based on estimates provided to CLASP by the Tax Policy Center, expanding the definition of qualified expenses would be modestly progressive. The percent change in after-tax income resulting from the change would decrease as income increases.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The Tax Policy Center estimates that expanding the definition of qualified expenses as described above would reduce federal revenues by \$65.4 billion over ten years (2013-2022). Limiting the expansion of qualified expenses to one or two items that especially affect low-income, nontraditional students, such as child care and transportation, would be a less costly and more efficient method of targeting expanded benefits to the most price-sensitive households. However, because of data

<sup>14</sup> For a full list of “certain related expenses,” refer to IRS Publication 970, *Tax-based student aid for Education*.

<sup>15</sup> This definition differs slightly based on the student. For instance, for incarcerated students, cost of attendance includes only tuition, fees, books, and supplies.

<sup>16</sup> This calculation assumes that the student has enough tax liability to take full advantage of the credit. A student with \$3,131 in qualifying expenses will receive \$2,000+\$282.75. For more information on how to calculate the credit, refer to Table 1.



limitations, we cannot provide specific distributional or budgetary estimates for such changes.

**OPTION 2A-F:** Increase and “front load” refundability of the AOTC.

**DESCRIPTION:** This option, in each of its six variations, would increase the value of the AOTC to those low-income households most sensitive to the price of education. Each variation relies on adjusting the overall AOTC refundability rate, the amount of the credit to which the refundability rate is applied, or both. The refundability rates in Options 2a-2f range from 60 to 100 percent. Of the variations that front load the credit, the amount of the credit to which the rates are applied ranges from the first \$1,000 to \$2,000.

**DISCUSSION:** The American Opportunity Tax Credit is one of many federal strategies to increase postsecondary enrollment and completion by reducing financial hardship. Because tax credits reduce tax liability, they are often of little use to low-income families who tend to owe less in taxes. In 2011, 78.5 percent of tax units without income tax liability earned \$30,000 or less (Tax Policy Center 2011). Further, in 2004, 46 percent of families with college students did not receive the full Hope or Lifetime Learning Credit because their income was too low (Long 2004). To incent enrollment, persistence, and completion by reducing financial hardship, the credit must target households most likely to respond to a financial incentive, in this case, students who are qualified to attend postsecondary education but face significant

**TABLE 2: Options to Improve Refundability of the AOTC**

**Current policy:** Eligible tax units with zero tax liability can receive 40 percent of their AOTC credit value as a cash refund. Because the maximum credit is \$2,500, the maximum refundable credit is \$1,000.

Option Description	Change in Maximum Refundable Credit Value
2a: Refund 60 percent of the entire credit value.	The maximum refundable credit increases from \$1,000 to \$1,500.
2b: Refund 100 percent of the first \$1,000 of the credit value.	The maximum refundable credit remains at \$1,000.
2c: Refund 100 percent of the first \$1,500 of the credit value.	The maximum refundable credit increases to \$1,500.
2d: Refund 100 percent of the first \$2,000 of the credit value.	The maximum refundable credit increases to \$2,000.
2e: Refund 80 percent of the first \$1,500 of the credit value.	The maximum refundable credit increases to \$1,200.
2f: Refund 80 percent of the first \$2,000 of the credit value.	The maximum refundable credit increases to \$1,600.

**Notes:** In each of the above options, the maximum nonrefundable credit remains at \$2,500.

**Source:** CLASP

financial barriers to doing so. (Box 1 explores similar types of improvements to the Hope Credit, in the event that the AOTC is allowed to expire at the end of 2017.)

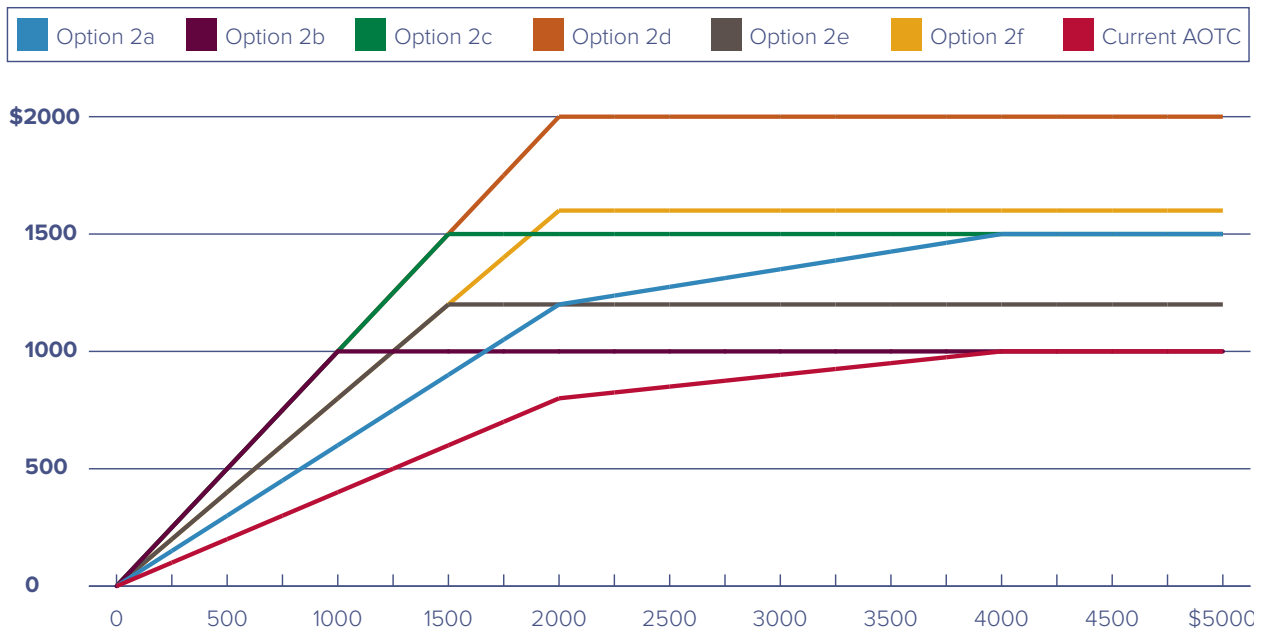
Options 2a-2f are designed to increase the incentivizing power of the AOTC by increasing its value to low-income students and improving the refundability structure. The refundability rates in Options 2a-2f range from 60 to 100 percent, and the amount of the credit to which the rates are applied ranges from the first \$1,000 to \$2,000. Figure 7 illustrates how the maximum refundable credit would change under each proposal and at varying levels of qualifying higher education expenses. Of the options presented, Option 2d, which applies a 100 percent refundable rate to the first \$2,000 of the credit, provides the most benefit to low-income households when compared with current AOTC parameters.

Front loading the refundable benefit would promote a level playing field for beneficiaries because the credit would be worth just as much to those with lower expenses and incomes as it is to other beneficiaries. For example, as Figure 7 shows, under current policy a low-income student with \$1,000 of qualified higher education expenses receives a refundable credit of \$400. Under any of our front loading options (2b, 2c, or 2d), that same student would receive a credit of \$1,000, the full value of his or her expenses, just as a high-income student would.

By increasing the value of the credit to households with little to no tax liability, these options help low-income families and increase the number of “marginal” students who could be incentivized to attend college by reducing financial barriers. It is important to note, though, that even under the most generous of these options, the maximum benefit that a household without tax liability could receive is still

**FIGURE 7: Options to Improve Refundability of the AOTC**

AOTC refundable credit value based on a student’s qualified expenses



**Notes:** As a student’s qualified expenses increase, so does the value of the credit. The height of the line indicates the maximum refundable credit value based on a student’s qualified expenses.

**Source:** CLASP



**TABLE 3: Estimated Revenue Effects of Proposed Options 2a-2f**

Option	10-Year Revenue Change (2013-2022)	Average Annual Revenue Change
2a: Refund 60 percent of the entire credit value.	-\$17.2 billion	- \$1.72 billion
2b: Refund 100 percent of the first \$1,000 of the credit value.	-\$4.1 billion	-\$ 405 million
2c: Refund 100 percent of the first \$1,500 of the credit value.	-\$21 billion	-\$2.09 billion
2d: Refund 100 percent of the first \$2,000 of the credit value.	-\$35.5 billion	-\$3.55 billion
2e: Refund 80 percent of the first \$1,500 of the credit value.	-\$10.5 billion	-\$1.05 billion
2f: Refund 80 percent of the first \$2,000 of the credit value.	-\$22.9 billion	-\$2.29 billion

**Notes:** Estimates may vary slightly due to rounding.

**Source:** CLASP, based on data provided by the Tax Policy Center.

less than that available to a household with enough tax liability to take full advantage of the credit.

#### **ESTIMATED IMPACT ON DISTRIBUTION OF**

**AID:** Based on estimates provided to CLASP by the Tax Policy Center, Option 2d is the most progressive option of those presented. Option 2f also significantly increases the after-tax income of low-income households. These results underscore the importance of the refundability component of the credit to price-sensitive households.

#### **ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

Table 3 shows the one-year and ten-year revenue estimates of the proposed options.

**OPTION 3:** Replace the four-year cap on AOTC with a lifetime maximum cap of \$10,000.

**DESCRIPTION:** The American Opportunity Tax Credit limits the time a student can claim the credit to “the

first four years of postsecondary education.”<sup>17</sup> This proposal replaces the four-year cap with a \$10,000 limit on lifetime usage. It would also explicitly limit the AOTC to undergraduates, preserving the intent of the original legislation. Households could not receive more than the current maximum annual credit (\$2,500), and only the actual benefit received would count against the lifetime maximum (that is, the amount that offsets tax liability and/or was paid as a refundable credit). For example, if a student without any tax liability is eligible to receive a \$1,000 nonrefundable credit but only receives the \$400 refundable portion (under current 40 percent refundability rules), then he or she would only deduct \$400 from the balance of the lifetime \$10,000 limit. In addition, under this proposal current restrictions on claiming multiple tax benefits for the same student in the same tax year would still apply.

<sup>17</sup> See 26 U.S.C. § 25A(i)(2).

**DISCUSSION:** The criterion that a student can only claim the AOTC for the first four years of postsecondary education creates confusion for academic institutions and students. The law does not stipulate academic versus calendar year, nor does it distinguish between full-time and part-time students. As highlighted by the GAO study by James White and George Scott (2012) on higher education tax credits, although a student may be in the fifth calendar year of school, “the student may be eligible for an AO[T]C if the 4-year university considers him to be in his third [or fourth] academic year.”

This confusion over how to define the first four years of postsecondary education creates a financial inequity between undergraduates who always attend full-time—less than half of all undergraduates—and those students who attend a mix of full and part-time (51 percent of undergraduates) or attend exclusively part-time (7 percent) (Shapiro et al. 2012). Moreover, the requirement that a student claim the credit in his or her first four years of postsecondary education punishes those who are unaware of the credit and do not claim it when they are first eligible. To ensure parity in benefits while continuing to encourage completion, any cap on benefits should ensure that all students have access to equal benefits. This is especially true given that low-income and underrepresented students are more likely to attend part-time for some of their college careers.

Implementing an overall \$10,000 cap on the benefits a student can receive, as proposed under this option, treats all students, part-time and full-time, equally and removes any confusion for students and institutions caused by the four-year requirement. At the same time, an overall cap does not incentivize drawing out attendance indefinitely. It is also worth noting that this approach has received significant political support. In 2012 Senator Charles Schumer (D-NY) proposed to make permanent the American Opportunity Tax Credit, including replacing the four-

year maximum with a \$15,000 cap.<sup>18</sup> This change would also ensure that undergraduates who currently receive the Lifetime Learning Credit because of the four-year limit could claim the AOTC instead if the LLC is eliminated.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The change could reduce federal revenues if individuals who otherwise would have become ineligible to claim the credit after the four-year limit continue to do so. At the moment, CLASP has no means of scoring the proposal’s impact because the Tax Policy Center model does not track tax-based student aid longitudinally. For the same reason, we could not estimate distributional impacts.

**OPTION 4:** Index the American Opportunity Tax Credit for inflation

**DESCRIPTION:** Unlike its predecessor, the Hope Credit, the AOTC is not indexed for inflation. Option 4 would adjust the credit for inflation along the lines of other major provisions in the tax code. IRS inflation adjustments typically occur in steps, only increasing the credit value after the inflation adjustment results in a certain dollar amount increase over a base year.

**DISCUSSION:** Over the last three decades, college costs have increased nearly four times faster than median family income and four and one-half times the rate of inflation (Harvey, 2012). While not matching cost increases in higher education, adjusting the maximum credit for inflation would at least provide some buffer against price increases until something more substantial is done to address the cost of postsecondary education more broadly.

**ESTIMATED IMPACT ON THE DISTRIBUTION OF**

**BENEFITS:** This would not affect the distribution of benefits. All elements of the credit would be indexed for inflation.

<sup>18</sup> Senator Schumer introduced S.3267, the American Opportunity Tax Credit Permanence and Consolidation Act of 2012, on July 6.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The impact of this option on federal revenues grows over time, with a relatively small effect of \$100 million in decreased federal revenue in 2014 but a 10-year revenue loss of \$17.1 billion (2013-2022).

**SIMPLIFY AND BETTER TARGET TAX-BASED STUDENT AID.**

**OPTION 5A AND B:** Lengthen the AOTC income eligibility phase-out period.

**OPTION 5A:** Begin phasing out AOTC income eligibility at \$140,000 and end eligibility at \$180,000 for married tax filers who file jointly. Begin the phase-out at \$70,000 and end it at \$90,000 for single tax filers.

**DESCRIPTION:** Option 5a doubles the length of the phase-out range of the AOTC for all categories of tax units.<sup>19</sup> This change would result in a smaller credit than the current AOTC award structure provides for filers in those income ranges.

**OPTION 5B:** Begin phasing out AOTC income eligibility at \$120,000 and end it at \$180,000 for married tax filers who file jointly. Begin the phase-out at \$60,000 and end it at \$90,000 for single filers.

**DESCRIPTION:** Option 5b triples the length of the original AOTC phase-out range for all categories of tax units. As with 5a, this change would result in a smaller credit than the current AOTC award structure provides to filers in that income range.

**DISCUSSION:** A major critique of current tax-based student aid is that it rewards behavior that would otherwise already occur, while not adequately assisting those for whom college enrollment is sensitive to price (Dynarski and Scott-Clayton 2007). For example, in 2009, almost 35 percent of AOTC benefits went to

households with an annual adjusted gross income of \$75,000 or more (Crandall-Hollick 2012). This aid distribution is partially explained by the AOTC's broad income-eligibility parameters. For married couples, the AOTC begins to phase-out at an adjusted gross income of \$160,000. In 2011, an income of \$160,000 for a married filing jointly tax unit corresponds to the 84th income percentile for married filing jointly households. For households that file as single or head of household, the AOTC starts to phase-out at adjusted gross incomes of \$70,000, which corresponds to the 90th income percentile for single and head-of-household tax units. (Tax Policy Center 2011)

Lengthening the phase-out ranges for all current recipients, instead of starting and ending the phase-outs earlier, generates revenue while reducing the possibility of "eligibility cliffs" or plateaus that occur when phase-outs reduce benefits as fast as or faster than income gains. This is especially problematic when phase-out ranges for multiple programs overlap (Steurlle 2012).

**ESTIMATED IMPACT ON THE DISTRIBUTION OF BENEFITS:** Lengthening the AOTC phase-out ranges decreases the share of benefits going to high-income households, while not completely eliminating the credit for households that are currently eligible.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:** According to estimates from the Tax Policy Center, Option 5a would increase federal revenues by approximately \$6 billion over 10 years (2013-2022). Option 5b would increase federal revenues by \$15 billion over 10 years (2013-2022). These two options make sense on their own merits when measured against our design criteria and could also provide the necessary resources to fund further policy improvements cited in Options 2a-2f, which total between \$4.1 billion and \$35.5 billion over 10 years. Alternatively, these revenues could be used to stabilize funding for the Pell Grant program.

19 The value of the AOTC credit would continue to phase-out at a constant rate.

### BOX 1: The Hope Credit, the American Opportunity Tax Credit, and Options for Reform

The American Opportunity Tax Credit is set to expire at the end of 2017 and revert to the Hope Credit. The Hope Credit was created by the Taxpayer Relief Act of 1997 along with the Lifetime Learning Credit and the student loan interest deduction. Before being replaced by the AOTC, the Hope Credit was available for the first two years of postsecondary education to students attending at least half time. The credit value (along with the income parameters) was adjusted for inflation and was similar in structure to the AOTC. To calculate the credit value in 2008, a household multiplied the first \$1,200 of qualifying expenses by 100 percent and the next \$1,200 by 50 percent, for a maximum credit value of \$1,800. In 2008, the Hope Credit started to phase-out at \$48,000 for single or head of household tax filers and at \$96,000 for households filing jointly (Crandall-Hollick 2012). Hope also had a narrower definition of qualified expenses than the AOTC does. And, unlike the AOTC, the Hope Credit was nonrefundable, making it much less beneficial to low-income families than the AOTC. On the other hand, because eligibility for Hope phased out at a lower income level than AOTC does, less of its total benefits went to high-income families.

#### OPTIONS FOR REFORM

If the AOTC is allowed to expire, it will revert to the Hope Credit, and the credit value and income phase-out ranges will be adjusted for inflation. Assuming Congress allows the inflation adjustment to occur as scheduled, the average benefit will increase in nominal terms. CLASP estimates that the maximum value of the Hope Credit would be \$2,100 (100 percent of first \$1,400 and 50 percent of the next \$1,400 in qualified expenses) for tax year 2018.<sup>20</sup>

The major criticisms of current tax-based student aid apply to the Hope Credit as well. It does not help the lowest-income households because it is nonrefundable. The structure of the credit does not incentivize enrollment or completion. And the complexity and number of other tax-based student aid provisions complicates decisions about which tax benefit to claim.

As shown in Table 1, the AOTC made significant changes to the Hope Credit with respect to refundability, time available, phase-out ranges, and value. If the AOTC expires in 2017, CLASP recommends that policymakers:

- *Make the credit refundable:* The current credit is nonrefundable, which drastically limits its ability to reach individuals who are sensitive to the cost of education. Policymakers should ensure that the credit is designed to maximize the value to low-income students by having a high refundable rate and by front loading the benefits.
- *Expand the definition of qualified expenses:* The AOTC slightly expanded the definition of qualified expenses to include course materials, such as text books. As discussed in Option 1, expanding the definition of qualified expenses to include expenses such as child care would promote equity, align with a student's actual cost of attendance, and ensure that students can take full advantage of the benefit.
- *Extend the eligibility period from two years to four years of postsecondary education:* Expanding the number of years the credit is available, or implementing some form of a benefit ceiling as proposed

<sup>20</sup> The value of the AOTC credit would continue to phase out at a constant rate.

under Option 3, would provide consistent support to students as they pursue an undergraduate education. If the Lifetime Learning Credit is eliminated, it would also ensure that Hope is available to those undergraduates who now receive the Lifetime Learning Credit.

**ESTIMATED IMPACT ON FEDERAL BUDGET:** According to estimates from the Tax Policy Center, if Congress had allowed the AOTC to expire in 2012, it would have generated \$116.6 billion in revenue over 10 years (2013-2022). Assuming Congress allows the credit to expire after 2017 and that projections hold constant over the ten-year period, allowing the AOTC to expire after 2017 will generate \$57.7 billion over ten years.

**OPTION 6:** Do not renew the deduction for tuition and fees.

**DESCRIPTION:** The tuition and fees deduction allows taxpayers to deduct up to \$4,000 in tuition expenses as an “above-the-line” deduction.<sup>21</sup> Households that claim this deduction may not also claim a higher education tax credit. In 2011, the deduction phased out for taxpayers with adjusted gross incomes of \$130,000 to \$160,000 (married filing jointly) and \$65,000 to \$80,000 (single and head of household). The tuition and fees deduction was extended for another year in the American Taxpayer Relief Act of 2012. Option 6 would permanently eliminate it.

**DISCUSSION:** The tuition and fees deduction provides a weak incentive to pursue postsecondary education. As discussed, deductions have the least value to individuals most likely to respond to a financial incentive because they disproportionately benefit those with the most tax liability (i.e., the highest incomes). More than 52 percent of the value from this deduction goes to families with adjusted gross incomes of \$75,000 or more (Tax Policy Center 2012). As mentioned above, this group is less price-sensitive to the cost of higher education and will likely attend without the additional financial incentive.

**ESTIMATED IMPACT ON THE DISTRIBUTION OF BENEFITS:** Eliminating the tuition and fees deduction would be a progressive change. The provision provides substantially more value to high-

income households than to low-income households. As discussed, low-income households tend to gain little value from deductions because they pay less in taxes and face lower marginal rates.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:** According to estimates from the Tax Policy Center, extending the tuition and fees deduction would reduce federal revenues by \$2 billion over 10 years (2013-2022), or an average of \$200 million annually. This revenue estimate assumes that individuals will be able to switch from the tuition and fees deduction to the Lifetime Learning Credit. If the LLC is eliminated alongside the tuition and fees deduction the total revenue generated will increase dramatically, to \$30.2 billion over 10 years.

**OPTION 7:** Eliminate the Lifetime Learning Credit.

**DESCRIPTION:** Option 7 would permanently eliminate the Lifetime Learning Credit. The LLC is a nonrefundable credit available to almost any student with higher education expenses. There is no restriction on the number of years a student can claim the credit, and it can be claimed on behalf of a dependent. The credit is equal to 20 percent of the first \$10,000 of qualified education expenses and, for tax year 2011, phases out between \$51,000 and \$61,000 for single and head of household filers and \$102,000 and \$122,000 for married couples filing jointly. The phase-out levels are indexed for inflation.<sup>22</sup>

21 Above-the-line deductions are available to all households regardless of whether they itemize deductions or claim the standard deduction.

22 The base income phase-out level is \$40,000 for single and head of household tax units and \$80,000 for married filing jointly tax units.



**DISCUSSION:** The LLC lacks many of the features that would improve its ability to increase postsecondary access and completion. The LLC is a nonrefundable credit, which limits its ability to influence college enrollment for those who are sensitive to the price of education. In 2009, for instance, 40 percent of LLC benefits went to households with annual adjusted gross incomes of \$60,000 or more. In contrast only 7 percent of LLC benefits went to those with adjusted gross incomes of less than \$20,000.

There is also reason to believe that the credit is used largely by graduate students. Based on NCES and IRS data, CLASP estimates that in FY 2008 (2007-08 academic year), 40 percent of all LLC benefits went to graduate students.<sup>23</sup> In 2008, a student was only able to claim the LLC, the Hope Credit, or the tuition and fees deduction. When Hope was converted to the AOTC, many third- and fourth-year undergraduates were better off claiming the new AOTC as opposed to switching to the LLC after exhausting Hope benefits. Therefore, it is likely that the share of LLC benefits going to graduate students is now even higher. Recent estimates from the Tax Policy Center showing that, in 2013, almost 64 percent of LLC benefits went to graduate students confirm this assumption.<sup>24</sup>

As discussed, to increase access, a financial incentive must target those who are sensitive to the

23 CLASP estimated this figure using data from the Department of Education and the Office of Management and Budget. In November 2011, NCES released its report, *Federal Higher Education Tax Benefits: Who Receives Them and to What Extent Do They Shape the Price of College Attendance?* The report estimated the share of students that receive an education tax credit based on NPSAS:08 data and separated recipients into undergraduate and total (defined by NCES as graduate plus undergraduate) recipients. For quality purposes, NCES verified its estimates against IRS estimates. CLASP calculated the share of benefits going to graduate students (approximately \$1 billion). The only tax credit available to graduate students is the Lifetime Learning Credit, which is nonrefundable. According to President Bush's FY2009 budget, total receipts for the Lifetime Learning Credit in FY2008 were approximately \$2.47 billion. Based on this figure, roughly 40 percent of the total benefits in FY 2008 went to graduate students.

price of education. Providing a tax credit to graduate students who already have an undergraduate degree and are therefore more likely to be economically secure in the future may help alleviate financial hardship, but it is a weak incentive to enroll in and complete college. Replacing the AOTC and Hope time limits with a benefit ceiling, as discussed in Option 3, could help undergraduates currently benefitting from the LLC to receive the AOTC or Hope Credit instead.

**ESTIMATED IMPACT ON THE DISTRIBUTION OF**

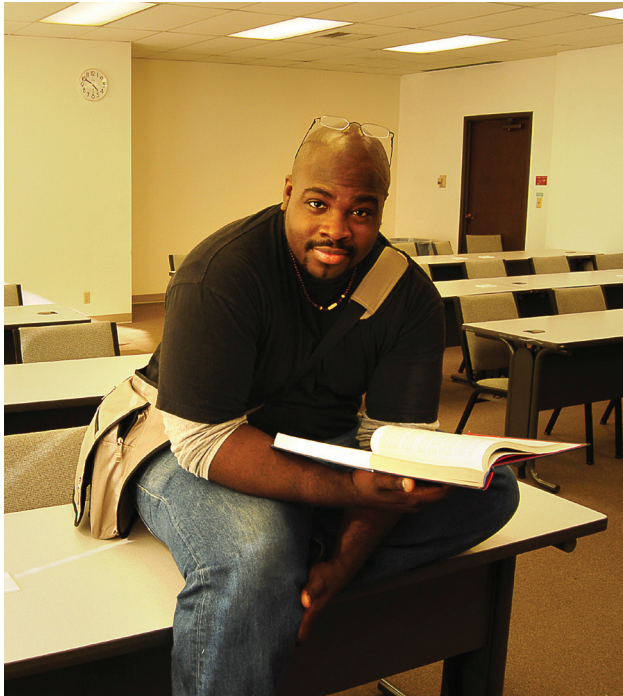
**BENEFITS:** According to estimates from the Tax Policy Center, eliminating the Lifetime Learning Credit would have mixed distributional effects. Many low- to modest-income households benefit from the Lifetime Learning Credit. The Tax Policy Center estimates that in 2013, 46 percent of the total benefit will go to families earning \$50,000 to \$100,000 per year. As noted, there is strong reason to believe that graduate students make up a substantial share of the recipients. However, the relatively low starting point of the phase-out prevents high-income households from using the credit.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

Eliminating the Lifetime Learning Credit would increase federal revenues by \$11.3 billion over 10 years, or an average of \$1.13 billion annually. As discussed under the previous option, the total revenue generated from eliminating both the LLC and the tuition and fees deduction is substantially more than the sum of eliminating either option alone, \$30.2 billion over 10 years.

**OPTION 8:** Eliminate the student loan interest deduction.

**DESCRIPTION:** Option 8 would eliminate the student loan interest deduction. This is an above-the-line deduction that allows households to deduct from their taxable income interest paid on loans (up to \$2,500) that were used to pay for tuition, fees, room, board, books, supplies and equipment, and other necessary expenses (e.g., transportation). The student must have been



enrolled at least half time in a program leading to a degree, certificate, or other recognized educational credential. In 2011, the phase-out ranges, which are adjusted for inflation, were \$60,000 to \$75,000 for single and head-of-household tax units and \$125,000 to \$155,000 for married filing jointly tax units.

**DISCUSSION:** A consensus point in literature on tax-based student aid is that timing matters (Brostek and George 2008; Reschovsky 2008; Crandall-Hollick 2012; and Dynarski and Scott-Clayton 2007). Separating the time between action and reward reduces the likelihood that the reward will encourage a behavior change as opposed to rewarding behavior that would otherwise already occur. The student loan interest deduction reduces financial hardship, but the large gap between the timing of the benefit and costs incurred reduces its ability to incentivize enrollment and completion. It is also worth noting that the deduction is relatively small when compared with the typical cost of attendance. Even for low- and modest-income households facing a 15 percent marginal tax rate,

the maximum possible benefit a household could receive is \$600, less than 4 percent of the average cost of attendance for a commuter student at a two-year public institution.<sup>25</sup>

As noted, deductions in general disproportionately benefit high-income households because the value of a deduction depends on one's marginal tax rate. The student loan interest deduction also benefits students who attend high-cost institutions and take out loans more than it benefits those who attend low-cost schools and combine school and work. In 2009, 49 percent of the benefits of the student loan interest deduction went to households with annual adjusted gross incomes of \$60,000 or more. Twenty-one percent of the total benefit went to households with annual incomes of \$100,000 or more (White and Scott May 2012).

The student loan interest deduction also adds to the complexity of the tax return. It can contribute to inadvertent errors, when taxpayers know how much they paid toward their student loans but not how much was attributable to interest as opposed to repayment of principal.

#### **ESTIMATED IMPACT ON THE DISTRIBUTION OF**

**BENEFITS:** Based on the Tax Policy Center's estimated 2013 distribution of the student loan interest deduction, eliminating the provision would disproportionately hurt high-income households. Almost 50 percent of the share of the overall benefit goes to households making more than \$75,000 per year.

#### **ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

According to the Tax Policy Center, eliminating the student loan interest deduction would generate \$11 billion over 10 years, or \$1.1 billion annually. These revenues could be used to fund improvements

25 The maximum a student could deduct from his or her gross income in tax year 2011 was \$4,000. The maximum savings equals the marginal tax rate multiplied by the amount of income shielded from taxation. According to the College Board, for 2012-13 the average estimated undergraduate budget for public two-year commuter students was \$15,584. This estimate includes tuition and fees, room and board, books and supplies, transportation, and other expenses (Baum and Ma 2012).

to the AOTC or to stabilize funding for Pell Grants, either of which would improve the targeting of federal student aid to those more likely to respond to financial incentives.

#### EXPAND OUTREACH AND PILOT “REAL-TIME PAYMENT” OF THE AMERICAN OPPORTUNITY TAX CREDIT.

**OPTION 9:** Require more aggressive outreach, including IRS-supported free tax-filing help, to increase receipt of the American Opportunity Tax Credit among eligible low-income students and parents.

**DESCRIPTION:** This option would require the IRS to take steps to improve awareness of the American Opportunity Tax Credit among low-income students and parents. This could be done by working with communities to conduct outreach campaigns and by providing free tax-preparation help, as the IRS does now for the EITC, through its Stakeholder Partnerships, Education and Communication function of the Wage and Investment Division. The IRS could also provide information on claiming the AOTC to students and parents when higher education institutions send them their 1098-T forms. It could also require the Department of Education to ensure that applicants using the FAFSA are aware of the AOTC by highlighting its availability within the *FAFSA on the Web* tool (for example, in the “help and hints” sidebar) and by adding it to the department’s “Financial Aid Shopping Sheet” (see Option 11 below).

**DISCUSSION:** Prior research on nonrefundable, federal tax-based student aid found that almost one-third of eligible taxpayers failed to claim these benefits (Maag et al. 2007). A more recent analysis, which did not include either the Hope Credit or the AOTC, found that 14 percent of tax filers (at least 1.5 million) do not claim tax-based student aid for which they appear to be eligible, and hundreds of thousands of others make suboptimal choices (i.e.,

*Prior research on nonrefundable, federal tax-based student aid found that almost one-third of eligible taxpayers failed to claim these benefits. [A more recent study] found that 14 percent of tax filers (at least 1.5 million) do not claim tax-based student aid for which they appear to be eligible...*

claiming a credit or deduction that does not provide the optimum benefit). (White and Scott May 2012) Some low-income students and parents likely fail to receive the American Opportunity Tax Credit because they do not meet the requirements to file a return and do not realize they could claim the refundable portion of credit.

The Tax Policy Center finds that participation in higher education tax credits tends to rise with income (Maag et al. 2007). Experience with other refundable tax credits for low-income families, such as the Earned Income Tax Credit, suggests that outreach campaigns, including free tax-preparation help, can significantly increase receipt of such benefits among this population (Center on Budget and Policy Priorities 2011; Holt 2011). Schools are reluctant to provide information to students about the AOTC because it is against the law to provide “tax advice” without training and information on individual circumstances. If the IRS provided sample materials that schools could use safely, then they might be more willing to do so.

In addition, making the AOTC more visible at the time that students and parents are applying for financial aid could increase the impact of the credit

on decisions about enrollment and college choice. However, a potential unintended consequence of such outreach might be that more of the AOTC's benefits are "captured" by other entities (e.g., commercial tax preparation companies; higher education institutions) in the form of higher fees and tuition. Research on the Hope and Lifetime Learning credits found little evidence that they resulted in higher tuition, though more recent research suggests that more selective, four-year institutions do reduce grant aid in response to tax-based student aid (Crandall-Hollick 2012; Maag et al. 2007; Turner 2010).

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The cost of an outreach program is small, yet increase in take-up due to the outreach program will have budget implications. Unfortunately, there is not enough information on AOTC-eligible filers who fail to claim the credit to model these costs.

**OPTION 10:** Test voluntary "real-time payment" of the AOTC through a joint Treasury-Education pilot.

**DESCRIPTION:** Require the departments of Treasury and Education to conduct a joint pilot to test "real-time payment" of a portion of the AOTC directly to institutions during the academic year on behalf of individual students and parents. In the pilot, the size of an individual's credit would be calculated automatically during the normal financial aid application process based on prior year tax data (or data from two years prior to enrollment, as necessary)<sup>26</sup> and current year qualified higher education expenses, as is now done in awarding other types of federal financial aid. To make this

as accurate as possible, Treasury and Education would have to link financial aid data with taxpayer data for the students and parents in the pilot, which they have begun doing with the FAFSA IRS Data Retrieval Tool. Real-time payments would be made at the start of each academic period (semester or quarter), ideally through the same mechanisms the Department of Education uses for transferring other student aid funds to institutions now, with Treasury first transferring the AOTC funds to Education.

Participation in the pilot would be voluntary for students and their parents, and only a portion of the total AOTC (such as 70 percent) due to a student would be made through real-time payment to protect against the possibility of credit overpayments. Real-time payments of AOTC would be treated as a resource for purposes of calculating other financial aid (because the payments would be part of the current tax year rather than the prior one). In addition, aid for students involved in the pilot would be repackaged to make the AOTC the "first payer" of tuition and fees rather than the Pell Grant. As part of the pilot, a beta version of EDEExpress (Education's financial aid software) could be developed to incorporate the AOTC, including making the AOTC the first payer. Colleges would be required to include the real-time payment portion of the AOTC on the college's student aid award letter along with other types of financial aid (and the IRS would release them from any legal liability for doing so). The pilot would include an independent evaluation to assess the feasibility of full implementation. It should also examine the potential impact on participation in the AOTC, college enrollment and persistence, the distribution of benefits, and the administrative burden to postsecondary institutions.

**DISCUSSION:** The timing and complexity of federal tax-based student aid limits its effect on college access and persistence. Real-time payment of the AOTC would align delivery of the largest tax-based student aid benefit with delivery of other federal financial aid. Calculating the AOTC automatically

26 Financial aid is typically calculated based on student and parent income for the preceding calendar year. However, because electronic retrieval of previously filed tax-return data is increasingly used both for prepopulation of the FAFSA and for income verification, this creates some problems (especially for state financial aid applications) that could be addressed by using income from two years preceding enrollment. The most recent reauthorization of the Higher Education Act created an Early Application demonstration in which the Education Department is authorized to use tax return information from two years preceding enrollment in postsecondary education to determine the expected family contribution.



as part of the normal student aid application process would make it much more likely that eligible families would receive the credit (as opposed to not applying for any tax-based student aid or applying for the wrong benefit).

In addition, integrating delivery of the AOTC with delivery of other federal financial aid would help families, at the time they make enrollment decisions, see how the credit lowers their college costs, and it would help ensure that they receive the credit when college bills are due, not months later. It would also enable financial aid administrators to package aid in a more coherent way than currently, because a family's AOTC award would be part of the total package. Currently, college financial aid offices have no involvement in delivery of the tax credits: college business offices or third-party providers generate the 1098-T. While direct payment would require changing the AOTC to allow use of prior year income to calculate a current year tax benefit, this has precedents in the financial aid system, where all aid is awarded based on prior year income and current educational expenses.

There are many challenges to real-time payment, not least of which is the degree of coordination and data sharing between the departments of Treasury and Education that it would require and the direct payment to a third party of a tax benefit due to an individual. This latter challenge is shared by a provision of the Affordable Care Act, which would pay individuals' health care insurance premium subsidies directly to their insurer, so some joint problem solving around that issue could occur. There is also the risk that making the value of each student's credit transparent to the college might result in colleges' raising tuition or fees accordingly (Crandall-Hollick 2012). Finally, there is a risk of overpayment of the credit if a student's circumstances change, though this risk is not high because the credit would be based on prior-year income data and current year college expenses, not

on projections.<sup>27</sup> Given that the AOTC is projected to total more than \$20 billion in FY 2012, it is critical to address the issues that limit its impact on college access and persistence (The Office of Management and Budget 2012).

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:** Because this is a pilot, the impact would be small.

**OPTION 11:** Add the AOTC to the Department of Education Financial Aid Shopping Sheet and require all Title IV institutions to use it.

**DESCRIPTION:** The Department of Education and colleges have several primary tools to help students and parents understand the cost of college and options for paying for it. These include Net Price Calculators with common data elements that all institutions are required to make available, student aid award letters that are crafted differently by each institution, and a new standardized, national model financial aid award letter, the Financial Aid Shopping Sheet, developed by the Department of Education and the Consumer Financial Protection Bureau.<sup>28</sup> The American Opportunity Tax Credit does not appear in any of these tools and so is invisible to students and parents at the time they decide about attending or persisting in college. This reform option would require adding the AOTC/Hope Credit to the Shopping Sheet and that all institutions receiving Title IV funds use the Shopping Sheet. (Currently, it is voluntary, reaching only about 13 percent of undergraduates.) The option would also require the Department of Education to explore incorporating an estimated credit into the template data elements for the Net Price Calculators. The estimated credit would be based on prior year income and so would have to include a disclaimer about the extent to which that credit might change if income were to change before the credit is claimed. As part of this

27 Although fear of overpayment was a factor in the low use of the advanced payment option of the EITC, reporting compliance issues among employers and recipients led to its repeal.

28 The Net Price Calculators are available at [http://nces.ed.gov/ipeds/resource/net\\_price\\_calculator.asp](http://nces.ed.gov/ipeds/resource/net_price_calculator.asp). For the Shopping Sheet, see [http://collegecost.ed.gov/shopping\\_sheet.pdf](http://collegecost.ed.gov/shopping_sheet.pdf).



*Despite the fact that the AOTC is now the third-largest source of federal aid for college behind grants and loans, the credit is invisible in the primary financial tools used to inform students and parents about financial aid when they are deciding whether to attend college and which institutions they can afford.*

option, the federal government would have to release institutions from legal liability for including the AOTC in financial aid information to students and parents because it is against the law for any entity to provide tax advice unless trained by the IRS.

**DISCUSSION:** The impact of financial aid on student and parent decisions depends in important ways on how well students and parents understand that aid (Deming and Dynarski 2009). Despite the fact that the AOTC is now the third-largest source of federal aid for college behind grants and loans, the credit is invisible in the primary financial tools used to inform students and parents about financial aid when they are deciding whether to attend college and which institutions they can afford. With the introduction of the IRS Data Retrieval Tool, the Department of Education will have greater access to more accurate income tax information as part of the normal federal student aid application process (the FAFSA). Many more aid applicants could likely use the IRS Data Retrieval Tool if they were allowed to use “prior, prior year tax data” (the tax year

from two years before enrollment), but currently Education only has the authority to allow that within the narrow context of a demonstration project.

With accurate tax information, it becomes feasible to estimate the amount of the AOTC benefit that individual students and parents would qualify for at a given set of college costs, if their income were to remain the same. However, colleges would need a liability waiver from the federal government for variations in the actual credit ultimately received because student and parent tax circumstances may change.<sup>29</sup> Making the AOTC more visible in the financial aid application process could also enable institutions to capture the benefit more easily through higher tuition and fees.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The additional federal costs would likely be small. However, institutions would face additional costs in revising their Net Price Calculators to provide an estimated AOTC for students.

**OPTION 12:** Require expanded analysis by the Treasury Department of tax-based student aid data, and take steps to link tax and financial aid data in order to coordinate tax-based aid with other federal aid policies and better analyze their results.

**DESCRIPTION:** Currently, the Treasury Department cannot share tax data without specific legislative authorization, and yet the IRS itself collects little of the student-level and institution-level information needed to understand the effects of current tax-based student aid or to understand interactions between tax-based student aid and other forms of aid. The Education Department also faces legal privacy restrictions that limit sharing of its data. This option proposes that statutory authority be given to Treasury and Education to link tax and financial aid data, perhaps through a Federal Student Aid Data

<sup>29</sup> The safest course would be to change the law regarding AOTC to base it on prior, prior tax year income so that the estimated credit and the actual credit would be the same.

Warehouse where individual-level data can be linked but personally identifiable information removed. This would enable policymakers to better coordinate these federal student aid benefits and researchers to better analyze the effects of tax-based student aid and its interactions with other types of federal student aid. As an intermediate step, this option requires Treasury to analyze the data it already has on tax-based student aid to shed light on questions policymakers have not been able to answer.

**DISCUSSION:** Currently, some basic questions about which types of students and institutions benefit from each of the various tax-based student aid provisions cannot be answered directly, nor can Treasury or Education provide information about which students and parents are eligible for each tax benefit but not claiming them. For example, there is a common assumption that the Lifetime Learning Credit primarily benefits graduate students. CLASP produced an estimate on this question in Option 7 using data from NCES and OMB, but an official estimate would require a direct connection between data from both the Department of Education and the IRS. Similarly, while Treasury has published important analyses of how tax-based student aid affects postsecondary enrollment, data limitations prevent it from digging deeper to analyze how tax-based aid affects enrollment choices between types of institutions or the impact of tax-based aid on credential attainment (Turner September 2011).

Treasury itself has very limited information on those claiming the credit, though this will improve somewhat with the revised Form 8863 in Tax Year 2012, which adds each institution's employer identification number. Further, lack of data limits the ability of Treasury to conduct targeted outreach and education efforts to eligible tax filers who are not claiming tax-based student aid: the Treasury Department does not have enough information on who these students and families are and why they are not claiming aid for which they are eligible (White and Scott May 2012). If Education and Treasury can find a way to



link their higher education data while protecting privacy, they potentially could also implement the recommendation of the Treasury's Inspector General for IRS to use Education data (specifically the IPEDS and SLDS databases) to verify the eligibility of filers claiming tax-based aid (Treasury Inspector General for Tax Administration 2011).

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:** The administrative costs associated with the implementation of this provision would be small relative to the costs of tax-based student aid. There is also the possibility of savings from reducing invalid claims.

## Combining Reform Options to Simplify and Improve Tax-Based Student Aid

Section II began by describing the three main criticisms of tax-based student aid: it provides little benefit to low-income students, it has little effect on college access or completion, and it is too complex and difficult to use. Our subsequent exploration of various reform options makes it clear that it is possible to address these problems by simplifying and better targeting federal tax-based student aid—and potentially redirecting some

revenue savings to stabilize the Pell Grant program—within a budget neutral framework.

We now combine these options in three alternative approaches that provide a general framework for reform. All of these proposals rely on improving the American Opportunity Tax Credit and simplifying the array of available tax benefits. Improving the refundability structure of the AOTC, as discussed under Options 2a-2f, will substantially increase the value of the credit to low-income students. To incent enrollment, persistence, and completion by reducing financial hardship, the credit must target households most likely to respond to a financial incentive—in this case, students who are qualified to attend postsecondary education but face significant financial barriers to doing so. Each proposal also adjusts the AOTC for inflation to provide a buffer against price increases until something more substantial is done to address the current cost trajectory of postsecondary education

In addition to what is included in the three proposals below, we believe two other AOTC improvements (Options 1 and 3) should be adopted that would ensure nontraditional students can fully benefit from this important source of student aid. First, expand the definition of qualified expenses to include child care and transportation. Second, replace the four-year AOTC limit with a lifetime \$10,000 limit. These two improvements are not included in the above proposals because it is not possible at this time for us to obtain revenue estimates for them. We are however able to evaluate the budgetary and distributional implications of expanding qualified expenses to align with the full Title IV cost of attendance definition. The advantages and disadvantages of doing so are discussed under Option 1.

Whatever the combination of improvements, reductions, or eliminations policymakers choose, we urge them also to consider the reforms we propose in Options 9 through 12. Without such action to improve outreach and delivery, the impact of tax-based student aid will always be constrained by the timing and information problems noted earlier.

**PROPOSAL ONE:** Simplify aid to just the American Opportunity Tax Credit and front load refundability.

This proposal would refund 100 percent of the first \$2,000 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; and eliminate the tuition and fees deduction, the Lifetime Learning Credit, and the student loan interest deduction.

**DISCUSSION:** Proposal One increases the maximum value of the refundable AOTC to \$2,000—doubling its current value—and indexes the credit for inflation. Applying the refundable rate to the first \$2,000 of the credit—“front loading” it—as opposed to applying a lower rate to the credit as a whole, will promote parity in benefit among different types of students. For example, under the current AOTC structure, a student with \$1,000 in qualifying expenses and zero tax liability is eligible to receive \$400 as a cash refund. Under this proposal, the same student would receive \$1,000 as a cash refund. This 1:1 ratio continues until the household reaches \$2,000 in qualifying expenses. Proposal One also targets the aid on the most price sensitive households by extending the phase-out range of the AOTC. This extension increases the share of benefits going to low- and modest-income households and provides revenue to help fund the improvement in the refundability structure of the credit. Together these changes strengthen the credit’s ability to incent college enrollment and persistence. Improving delivery, such as through the “real-time payment” of the AOTC discussed earlier, would increase this incentive effect even more.

Lastly, the package greatly simplifies the current set of higher education tax benefits by eliminating three of them: the Lifetime Learning Credit, the student loan interest deduction, and the tuition and fees deduction. These eliminations provide the revenue

necessary to improve the AOTC while making it easier for students and parents to understand what student aid is available to them through the tax code. It is important to note though that these provisions are not entirely duplicative; that is, eliminating these provisions and improving the AOTC will not leave everyone equal or better off. For example, in addition to many graduate students, many fifth year undergraduate students also utilize the LLC. Full elimination of the LLC will hurt these fifth year students and could potentially lengthen their time to completion.

There are ways to address these shortcomings. For instance, a benefit ceiling, as discussed under Option 3, would promote parity across half- and full-time undergraduate students regardless of how long they have been attending college. An alternative option is to eliminate benefits for certain groups and preserve them for others. The latter approach is discussed in Proposal Two with respect to the LLC and graduate students.

**ESTIMATED IMPACT ON DISTRIBUTION OF AID:**

Expanding refundability of the AOTC to the first \$2,000 of the credit, indexing the credit for inflation,

lengthening the phase-out period, and eliminating the student loan interest deduction, the Lifetime Learning Credit, and the tuition and fees deduction results in a more progressive distribution of tax-based student aid.

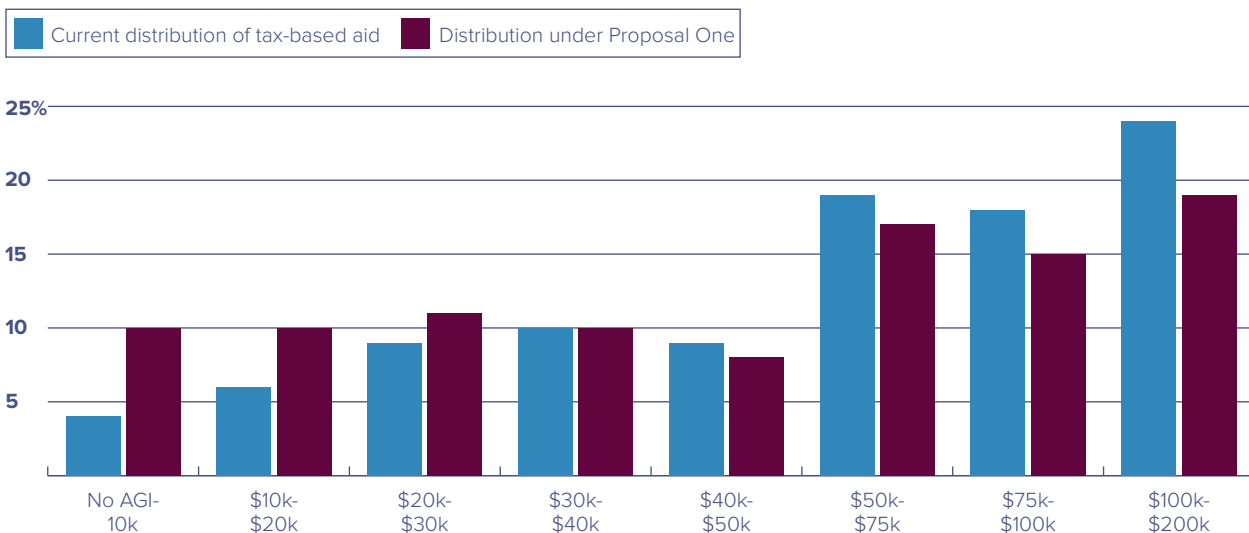
Figure 8 shows the value of tax-based student aid by income category before and after the changes in Proposal One by income category. As a whole, the proposal results in more aid going to low-income households than under the current distribution. The distribution is more progressive yet still provides substantial value to modest- and higher-income households.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The increase in revenue resulting from these changes is enough to improve the AOTC substantially on a cost-neutral basis. The Tax Policy Center estimates that increasing the refundability rate of the AOTC to 100 percent of the first \$2,000 of qualified tuition and related expenses and indexing the credit for inflation, while phasing out the AOTC at lower levels of income and eliminating the tuition and fees deduction, the student loan interest deduction, and the Lifetime Learning Credit, would result in a

**FIGURE 8: Distribution of Tax Aid Under Proposal One**

Percent distribution of tax-based student aid by type and income category in 2013



Source: CLASP, based on estimates from the Tax Policy Center.



relatively small revenue loss of \$800 million over 10 years (2013-2022). Unfortunately, this would leave no funding to improve the Pell Grant program. One way to address this is through elements of the reform package described in Proposal Two, which adjusts the refundability rate to 100 percent of the first \$1,500 of the credit (Option 2c) instead of the first \$2,000 (Option 2d). As shown in Table 3, this would cost \$14.5 billion less than the Option 2d over ten years which could be used to help address the Pell Grant funding gap and for student aid innovations, such as the Compact for College Completion described in Section III.

**PROPOSAL TWO:** Simplify aid but preserve both the American Opportunity Tax Credit and the Lifetime Learning Credit for undergraduates only. Front load refundability of the AOTC.

This proposal would refund 100 percent of the first \$1,500 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; eliminate the student loan interest deduction and the tuition and fees deduction; and eliminate the Lifetime Learning Credit for graduate students only.

**DISCUSSION:** As mentioned above, the elimination of the student loan interest deduction, the Lifetime Learning Credit, and the tuition and fees deduction leaves some groups worse off (e.g., graduate students, less than half time students). Moreover, the expansion of the AOTC leaves no revenue to help stabilize Pell funding. Proposal Two is an attempt to preserve the benefits of Proposal One while addressing its potential shortcomings.

Proposal Two increases the maximum value of the refundable AOTC to \$1,500—a 50 percent increase over its current value—and indexes the credit for inflation. The refundability options in Proposals One and Two are identical for the first \$1,500 of qualified expenses. Under Proposal Two, a student with \$2,000 in qualifying expenses and zero tax



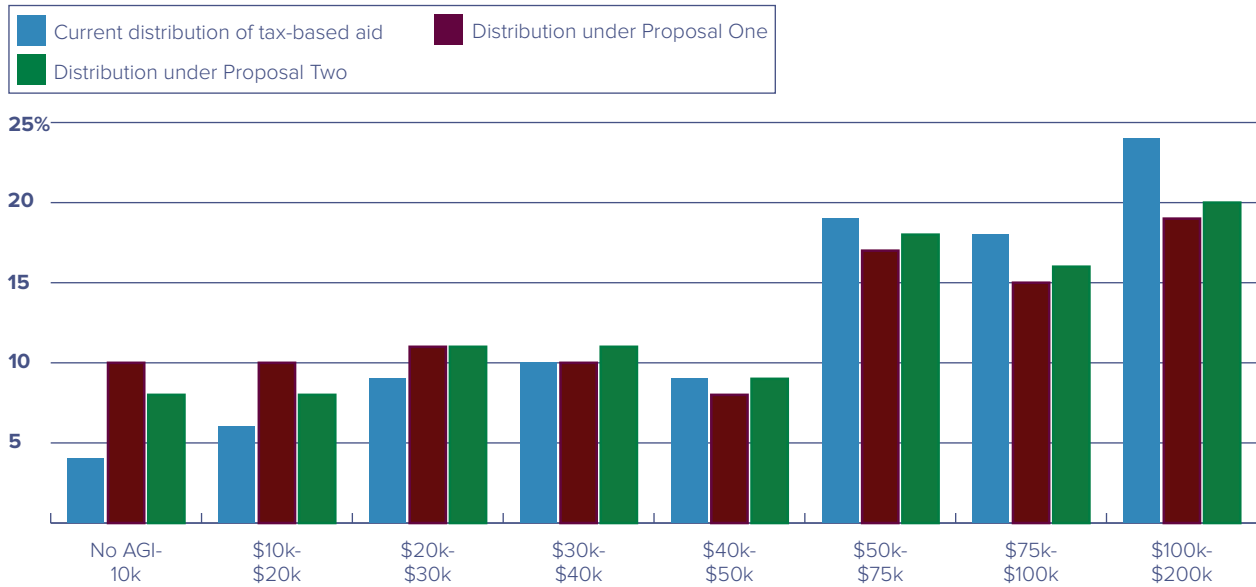
liability would receive \$1,500 in a refundable credit and \$500 in non-refundable credit. As with Proposal One, the new refundability structure is well-designed to reach those households most sensitive to the cost of education. Also similar to Proposal One, Proposal Two targets the aid on more price sensitive households by extending the phase-out range of the AOTC.

Proposal Two relies on a slightly different set of eliminations to simplify the current tax provisions and provide revenue to fund the improvements to the AOTC. Proposal Two eliminates the student loan interest deduction and the tuition and fees deduction. It also eliminates the Lifetime Learning Credit *for graduate students only*. Eliminating the Lifetime Learning Credit for graduate students only preserves the credit for some students who would be worse off under Proposal One, such as undergraduates who are in their fifth year of



**FIGURE 9: Distribution of Tax Aid Under Proposals One and Two**

Percent distribution of tax-based student aid by type and income category in 2013



Source: CLASP, based on estimates from the Tax Policy Center.

studies, are attending less than half time, or are not seeking degrees.

**ESTIMATED IMPACT ON DISTRIBUTION OF AID:** The distributional impact of the proposal to expand the AOTC to the first \$1,500 of the credit, index the credit for inflation, lengthen the phase-out period (\$120,000 to \$180,000), and eliminate the student loan interest deduction, the Lifetime Learning Credit for graduate students only, and the tuition and fees deduction is similar to Proposal One. Compared to current policy, those making less than \$40,000 annually will see an increase in the amount of tax benefits they receive, those making between \$40,000 and \$100,000 may see a slight reduction, and those making more than \$100,000 will see a relatively larger reduction. Compared to Proposal One, Proposal Two provides less aid to lower-income tax filers because the LLC is a nonrefundable credit and preserving LLC benefits to undergraduates is paid for by choosing a smaller AOTC refundability option. Figure 9 shows this tradeoff, with tax filers with incomes below \$25,000 worse off under Proposal Two than under Proposal One. However, both recommendations improve the

targeting of tax-based student aid when compared with current policy.

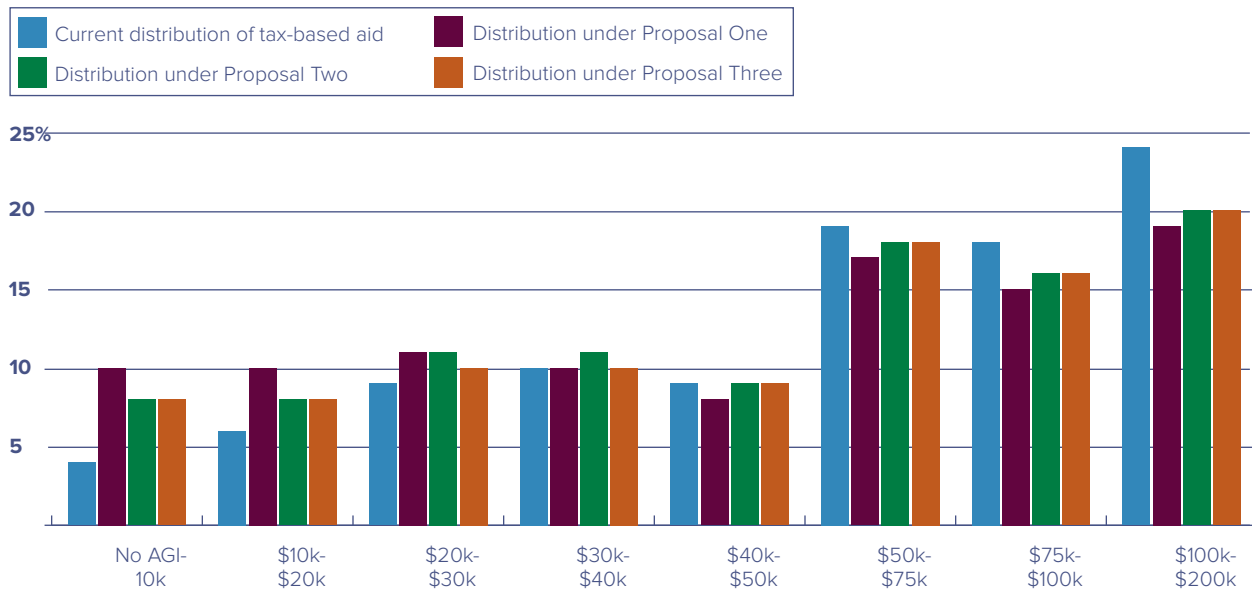
**ESTIMATED IMPACT ON THE FEDERAL BUDGET:** The Tax Policy Center estimates that increasing the refundability rate of the AOTC to 100 percent of the first \$1,500 of qualified tuition and related expenses and indexing the credit for inflation, while phasing out the AOTC at lower levels of income and eliminating the tuition and fees deduction, the student loan interest deduction, and the Lifetime Learning Credit for graduate students only, would result in a revenue gain of \$4.8 billion over 10 years (2013-2022). This additional revenue could be redirected towards the Pell Grant program and to innovation.

**PROPOSAL THREE:** Simplify aid but preserve both the American Opportunity Tax Credit and the student loan interest deduction. Front load refundability of the AOTC.

This proposal would refund 100 percent of the first \$1,500 of AOTC; index the AOTC for inflation;

**FIGURE 10: Distribution of Tax Aid Under Proposals One, Two, and Three**

Percent distribution of tax-based student aid by type and income category in 2013



Source: CLASP, based on estimates from the Tax Policy Center.

lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; and eliminate the tuition and fees deduction and the Lifetime Learning Credit.

**DISCUSSION:** Proposal Three is similar to Proposal Two but with two major differences: it preserves the student loan interest deduction and eliminates the Lifetime Learning Credit. This alternative anticipates that Congress' recent action to make permanent the expanded student loan interest deduction may signal a lack of interest in eliminating this benefit as part of tax simplification. Like the first two proposals, this package simplifies and better targets tax-based student aid but it provides slightly less aid to low- and modest-income families than Proposal Two and has the same negative effects on current undergraduate recipients of the Lifetime Learning Credit that Proposal One does.

**ESTIMATED IMPACT ON DISTRIBUTION OF AID:** Expanding refundability of the AOTC, indexing

the credit for inflation, lengthening the phase-out period, and eliminating the Lifetime Learning Credit and the tuition and fees deduction results in more tax-based student aid going to the most price sensitive households compared to current policies, though significantly less so than under Proposal One. The distribution is progressive yet still provides substantial value to modest- and higher-income households. Figure 10 shows the value of tax-based student aid by income category before and after the changes in Proposal Three and compares this to the distribution under Proposals One and Two.

**ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

The increase in revenue resulting from these changes is enough to improve the AOTC substantially and to generate a modest amount of additional revenue. The Tax Policy Center estimates that increasing the refundability rate of the AOTC to 100 percent of the first \$1,500 of qualified tuition and related expenses and indexing the credit for inflation, while phasing out the AOTC at lower

levels of income and eliminating the tuition and fees deduction and the Lifetime Learning Credit, would result in a modest revenue gain of \$3.6 billion over 10 years (2013-2022). This additional revenue could be used to help address the Pell Grant funding gap and for innovation, such as the Compact for College Completion described in Section III.

These three reform packages illustrate possibilities for simplifying and better targeting federal tax-

based student aid to low- and modest-income households. All of the proposals rely on the same general strategy to make the tax provisions more efficient, effective, and simple. Adjustments, such as altering the extent of refundability or relying on an alternative set of eliminations, could be made to meet certain goals (e.g., securing more revenue for the Pell Grant program and for innovation to increase completion).

### III. Using Performance Metrics to Address Affordability and Completion Challenges



While many organizations nationally are involved in developing specific higher education performance measures, there has been little discussion about how best to use performance metrics to help reform federal student aid.<sup>30</sup> In particular, not enough attention has been paid to how performance metrics could support policies that aim to improve access, increase affordability, and promote higher rates and numbers of completions. To stimulate a thoughtful conversation on this topic, we have conducted an initial review of literature on current practices and initiatives that seek to use student outcome metrics

to establish accountability for results, influence the allocation of public resources for higher education, support continuous improvement and evaluation, and improve the availability of outcome data to policymakers and students.

The focus of our review is to explore potential uses of performance metrics in federal higher education policy, not to recommend specific metric definitions. We review the use of various types of performance metrics for several applications and suggest some lessons learned from these uses. We then apply these lessons to the development of three options for using metrics as part of a set of policy innovations intended to promote our overarching goals of making federal student aid more effective, more efficient, and simpler for students and parents to understand and use wisely.

30 These efforts include the federal Committee on Measures of Student Success, the American Association of Community College's Voluntary Framework for Accountability, and the National Governors Association's Complete to Compete initiative.

TABLE 4: Overview of Current Federal Use of Performance Metrics in Higher Education

Provision	Application			
	Accountability	Funding Access and Distribution	Career Guidance and Public Disclosure	Continuous Improvement
<b>Institutional eligibility requirements for Pell; cohort default rate thresholds:</b> These rates are set high enough that few institutions are disqualified. The default window will soon be extended to three years.		●	●	
<b>Program eligibility requirements for Pell:</b> Gainful employment requirements for loan repayment rates and the percent that loan repayments constitute of typical annual and discretionary student incomes. These requirements are on hold as a result of court action.		●	●	
<b>Program eligibility requirements for short-term programs:</b> Completion rates standard is applied.		●	●	
<b>Pell institutional disclosure requirements:</b> A wide variety of institutional disclosure requirements apply; most recent additions include graduation rates for Pell recipients.			●	
<b>Perkins career and technical education postsecondary performance measures:</b> Degree attainment and employment outcome goals for states; states apply requirements to institutions.	●			●
<b>Workforce Investment Act Title I; state-approved training provider requirements:</b> Most states have received waivers from the U.S. Department of Labor to the requirement for completion and employment results for all students, but they provide information on these rates for students funded by WIA.		●	●	

## Current and Potential Uses of Performance Metrics

Performance metrics are used in several ways as part of current federal higher education policy (Table 4). The primary application of metrics is through institutional and program eligibility for access to Pell

Grants, student loans, and other assistance funded under Title IV of the Higher Education Act. This includes the use of a student cohort loan default rate requirement for institutions and separate completion targets for short-term programs. In addition, a wide array of disclosure requirements are applied to institutions under Title IV, including graduation



rates, loan default rates, and employment rates for certain programs. A broader application of loan repayment metrics to programs under the “gainful employment” regulations is on hold as a result of court action. Beyond Title IV, performance metrics are applied under federal policy for accountability and continuous improvement to postsecondary institutions through the Perkins Career and Technical Education program and the Workforce investment Act Title I.

### APPLICATIONS OF METRICS

Our literature review focused on four applications of performance metrics: accountability and performance management, funding access and distribution, continuous improvement and evaluation, and career guidance and public disclosure.

#### ACCOUNTABILITY AND PERFORMANCE

**MANAGEMENT.** Performance metrics are used to hold some programs accountable for overall achievement of program objectives, including state and local programs under the Workforce Investment Act Titles I and II and the Carl D. Perkins Career and Technical Education program. When these accountability systems are accompanied by high-stakes consequences (e.g., reduction in funding, loss of autonomy, or externally imposed reorganization, as they have been under WIA), they can have strong impacts on program design and targeting (Social Policy Research Associates 2005). Institutions that have the ability to adjust targeting and participant-selection policies can respond to performance pressures by becoming more selective in who they enroll, as well as by raising performance expectations for other providers with which they work. Institutions that enroll small numbers of participants can become especially risk averse, given the impact a single person can have on overall results. This makes it even more important to select measures that promote the overall goals of the program and do not create disincentives to serving less-educated and disadvantaged individuals (Ganzglass 2010), as has occurred under WIA Title I.

*A review of performance-based funding allocation models found that these models increased institutional focus on the measured outcomes and led to intermediate changes in institutional practices... four studies [among those reviewed] found evidence that colleges responded to the funding changes by restricting admission of less-prepared students.*

**FUNDING ACCESS AND DISTRIBUTION.** In addition to using metrics at the federal level to condition access to Pell Grants under Title IV, states have used performance metrics as part of performance-based models for allocating funds to colleges (Harnish 2011). A review of performance-based funding allocation models found that these models increased institutional focus on the measured outcomes and led to intermediate changes in institutional practices that were perceived as related to performance (Dougherty and Reddy 2011). There was weak evidence that these models improved outcomes for students, though it is possible that the models had not been in place long enough to realize such improvements. In addition, this study cited four studies of performance-based funding that found evidence that colleges responded to the funding changes

by restricting admission of less-prepared students. This study and others reviewed best practices and provided recommendations for appropriate design of performance-based higher education funding models (Harnish 2011; Quinterno 2012). We have incorporated lessons from this work into our summary of implications for reform.

#### **CONTINUOUS IMPROVEMENT AND EVALUATION.**

Performance metrics can play a key role in institutional continuous improvement and program evaluation initiatives. These metrics can provide a bottom line (or more likely, multiple ones) that supports analysis of results and focuses improvement efforts. MDRC examined findings from the 26 first-round colleges under Achieving the Dream, including the extent to which the colleges implemented practices associated with a “culture of evidence,” as well as “intervention strategies designed to improve student outcomes” (Rutschow et al. 2011). Achieving the Dream is a national reform network dedicated to community college student success and completion; it focuses on helping low-income students and students of color earn postsecondary credentials. Achieving the Dream is based on the premise that to improve student success on a substantial scale, colleges need to fundamentally change the way they operate.<sup>31</sup> Key to this change is helping community colleges build a “culture of evidence” by using student records and other data to examine how students are performing and identify barriers to academic progress.

The MDRC study found that four out of five Achieving the Dream colleges had “adopted practices associated with a moderate to strong culture of evidence” (Rutschow et al. 2011). It also found that there had not yet been any substantial improvements in student outcomes, such as progress in developmental education, completion of “gatekeeper” courses, higher grades, and persistence in and completion of credential programs. The study did find “modest improvements in gatekeeper (introductory) college



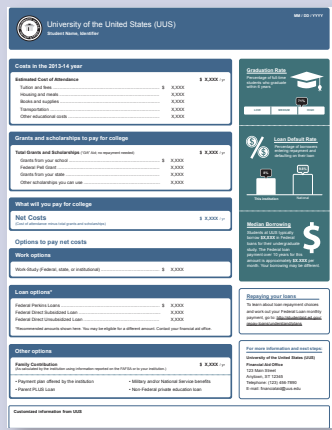
English courses and the completion of courses attempted within the first two years.” This suggests that improvement efforts such as this take time to yield results that can be evidenced by increases in overall student outcomes, especially because improvement strategies must grow to scale to have broad impact. The study found that “a majority of these reforms [strategies to improve student achievement] reached less than 10 percent of their intended target populations,” so lack of scale was likely an important limiting factor.

**COLLEGE AND CAREER GUIDANCE AND BETTER PUBLIC INFORMATION ON RESULTS.** A wide array of disclosure requirements apply to institutions under Title IV, as outlined above, and these requirements are intended to inform students about important aspects of cost, loan repayment, and other results at the institutional level. There has been increased demand by Congress and the Obama administration for better information on institutional and program outcomes, especially completion data and post-graduation employment and earnings. Notable examples of this

31 See [www.achievingthedream.org](http://www.achievingthedream.org)

are the recent introduction of the “Student Right to Know Before You Go Act” (S.2098, see Option Two), which calls for substantially expanding information on most postsecondary programs’ completion and earnings results, as well as testimony before the House Subcommittee on Higher Education and Workforce Training on September 20, 2012. In addition, Senator Patty Murray has introduced S.2241, the GI Bill Consumer Awareness Act of 2012, which requires the Veterans Administration to make available to veterans (and others eligible to receive educational assistance through the VA or the Defense Department) specified information about educational institutions and the programs of study available. The act also would create related consumer protections for the same targeted groups.

A final example of this movement toward greater transparency is the Financial Aid Shopping Sheet developed by the Department of Education (see box). As of November 2012, over 500 institutions—serving about 13 percent of undergraduates—have adopted the Shopping Sheet voluntarily (U.S. Department of Education 2012). In addition to



The Financial Aid Shopping Sheet is a consumer tool that participating institutions use to notify students about their financial aid packages. It is a standardized form designed to simplify the information prospective students receive about costs and financial aid so that they can compare institutions easily and make informed decisions about where to attend school. The Shopping Sheet is available for use for the 2013-14 award year (U.S. Department of Education 2012).

information on costs, grant, and loan options for the student, the Shopping Sheet contains data on the institutional graduation rate, the loan default rate, and median borrowing.

George Kuh (2007) summarized the promises and pitfalls of the current impetus toward transparency of results for postsecondary institutions. His recommendations include: select appropriate measures that are linked to student success in the context of the institution’s mission, evaluate the quality of the data on which performance indicators are based, and use performance indicators appropriately, which includes being clear for what audiences the metrics are intended, providing sound comparisons between institutions, and using metrics that institutions can influence.

Even with substantial improvements in the collection and availability of data on postsecondary degree and certificate programs, there remains a dearth of information on enrollments, completions, and industry credentials attained via the noncredit educational market. According to the NCES National Household Education Survey, the noncredit student headcount, which was 90 percent of the credit student headcount in 1995, grew to exceed it by more than 8 percent in 1999 (cited in Van Noy et al. 2008). While addressing this particular issue is beyond the scope of our recommendations, over the longer term these students and their outcomes will need to be incorporated into our systems for reporting and transparency.

## TYPES OF METRICS

A wide array of metrics has been developed for the above applications. Our objective here is not to recommend specific metrics for specific uses but to suggest appropriate uses of types of metrics from a broader “menu” for three policy options (Table 6). The range of potential measures has been grouped into four tiers: Tier 1, access and affordability measures; Tier 2, interim measures of student progress; Tier 3, completion and credential attainment

**TABLE 5: Metric Tiers and Examples**

Tier	Focus	Examples
<b>1. Access and affordability</b>	College access, college costs, adequacy of need-based aid, and debt burdens upon exiting postsecondary education or training	<ul style="list-style-type: none"> <li>• Percent of entering students who receive Pell Grants</li> <li>• Percent who are underrepresented minorities</li> <li>• Percent receiving need-based financial aid</li> <li>• Loan repayment rates</li> <li>• Debt-to-degree ratio</li> <li>• Student default risk index score (the cohort default rate multiplied by the share of students borrowing)</li> </ul>
<b>2. Interim measures of student progress</b>	Progress of student cohorts toward completion	<ul style="list-style-type: none"> <li>• Percent of students completing developmental education courses</li> <li>• Percent of students completing gateway courses</li> <li>• Credit accumulation</li> <li>• Percent of students who take three courses in a program of study within two years of enrolling</li> </ul>
<b>3. Completion and credential attainment</b>	Student completion and attainment of credentials	<ul style="list-style-type: none"> <li>• Percent of students in a cohort who attain a credential, transfer, or are still enrolled within specified timeframes</li> </ul>
<b>4. Employment and earnings</b>	Labor market results	<ul style="list-style-type: none"> <li>• Percent of former students employed</li> <li>• Average earnings of former students</li> <li>• Average earnings gain of former students</li> </ul>

measures; and Tier 4, employment and earnings measures (*Table 5*). Within each of these categories, the reported data on each measure should be broken down by race/ethnicity, gender, receipt of Pell Grants, and include all credential-seeking students, including those who attend part-time, those who transfer in, and those who first enroll in the spring or summer.

**TIER 1: ACCESS AND AFFORDABILITY MEASURES.** This tier includes institutional measures of college

access, college costs, adequacy of need-based aid, and debt burdens upon exiting postsecondary education or training. Examples of these types of measures include the percent of entering students who receive Pell Grants, the percent who are underrepresented minorities (both are used in the Education Trust’s Access to Success initiative), the percent receiving need-based financial aid, loan repayment rates of former students, and the



ratio of student debt to degree or credential (as suggested by the Education Sector).<sup>32</sup> This measure is calculated by dividing the total amount of money undergraduates borrowed by the total number of degrees awarded. A refinement of the debt burden measure would be to break this out by field of study.

#### **TIER 2: INTERIM MEASURES OF STUDENT**

**PROGRESS.** This tier includes measures that focus on the progress of student cohorts toward completion. Examples of these types of measure include the percent completing developmental education courses, the percent completing gateway courses, credit accumulation, and the percent of students who take three courses in a program of study within two years of enrolling (a key measure in the national Completion by Design initiative).<sup>33</sup>

#### **TIER 3: COMPLETION AND CREDENTIAL**

**ATTAINMENT MEASURES.** This tier includes measures focused on student completion, such as the percent of students in a cohort who attain a credential, transfer, or are still enrolled within specified timeframes. These might be broken out further for specific subgroups, such as those identified as needing remediation, as recommended by the federal Committee on Measures of Student Success (U.S. Department of Education 2011). A further refinement of the transfer measure could look at whether a student transferred with advanced standing in a program of study. If the outcomes are broken out by enrollment status, three categories should be used: always enrolled full-time, always enrolled part-time, and mixed enrollment status. Outcomes for these three groups look distinctly different in the research.

#### **TIER 4: EMPLOYMENT AND EARNINGS**

**MEASURES.** This tier includes measures that focus on labor market results, such as the employment rate of former students and average earnings or earnings gain after exiting postsecondary education or training. These measures are especially useful for analyzing program-level results.

32 See: [http://www.educationsector.org/sites/default/files/publications/Debt%20to%20Degree%20CYCT\\_RELEASE.pdf](http://www.educationsector.org/sites/default/files/publications/Debt%20to%20Degree%20CYCT_RELEASE.pdf).

33 See: <http://completionbydesign.org/>

## CLASP's Guiding Principles for Using Metrics in Higher Education Reform

Our scan of how performance metrics have been used suggests several principles for using metrics as part of a strategy to redesign student financial assistance. These principles address four key aspects of metric development and use: selecting and defining metrics, using metrics to allocate resources, avoiding unanticipated consequences, and connecting metrics to ongoing improvement.

#### **Selecting and defining metrics:**

- Choose metrics carefully to ensure that they reflect the goals of student access, progress, completion, and earnings.
- In particular, include performance criteria that reward intermediate outcomes, such as developmental education completion, gateway course completion, and credit accumulation, as well as ultimate outcomes, such as credential and degree attainment and employment.
- Ensure measurements are based on sound, comparable, and understandable information.

#### **Using metrics to allocate resources:**

- Ensure that the metrics incorporate incentives for institutions to focus resources on improving results for underrepresented students, especially low-income youth and adults.
- If funding incentives are being implemented, make sure they are large enough to affect behavior, otherwise the significant effort to design the system will be wasted.

#### **Avoiding unanticipated consequences:**

- Consult with the affected institutions and systems to communicate goals clearly, identify issues, and work for buy-in.



- If possible, avoid “threshold effects” (e.g., disqualifying institutions from funding based on a single criterion) that can create strong incentives to game results, distort institutional missions, or create other undesired results (e.g., a threshold that can disqualify an institution from funding is more problematic than an incentive built into the allocation formula for institutions).
- Provide an initial pilot or phase-in period so that unanticipated consequences can be detected and adjustments implemented.

#### **Connecting metrics to ongoing improvement:**

- Encourage institutions to forge connections between metrics of student success used for financial aid policy and the institution’s own continuous improvement planning.
- Apply policy levers using performance metrics to the entity that is in a position to implement changes that may be needed to improve results.

## Federal Policy Reform Proposals

Based on our scan of the literature, the lessons learned, and our overall objectives for policy change, we have developed three policy proposals that would use performance metrics to promote improvements in postsecondary access, equity and completion: expand federal reporting on key measures of affordability, student progress, and completion and simplify existing disclosure requirements; through the states, expand public reporting of program-level outcomes, including employment and earnings; and create a national, voluntary Compact for College Completion. These proposals aim to provide students, parents, and policymakers with much better information on results to inform their postsecondary decision making and to incent students and colleges to take action to increase completion. Table 6 summarizes these policy proposals and identifies the metric tiers from which specific metrics would be selected to support implementation of each option.

While better reporting of more relevant results may lead to the development of thoughtful performance-based funding ideas over the long term, our analysis, as well as our consultation with several higher education experts, leads us to reject for now reform options that would expand the use of performance metrics to determine funding levels or eligibility for federal student aid. For example, we had considered options for phasing in a requirement for collecting, reporting, and using minimum outcome levels for all programs of study for Title IV eligibility, not just for those qualifying as programs leading to gainful employment. We became convinced that the potential negative effects of expanding the application of performance metrics significantly as a basis for determining institutional or student eligibility for federal student aid could outweigh the potential benefits. We are especially concerned about the potential unintended consequences on access for underrepresented students and those at higher risk of not completing college. If not carefully designed, these options also would violate one of our guiding principles for using metrics: avoid “threshold effects” that could result in gaming by institutions in ways that could restrict access for students.

We view it as more important at this moment to improve the performance data that are collected and made publicly available and to adopt more nuanced approaches to working with students, parents, and institutions to improve results. Collecting better data in the ways we propose would enable policymakers to explore the feasibility of tying program or institutional eligibility to performance down the road; at the moment there is not even solid baseline data for designing such requirements. Two of our options involve improvements to the collection and availability of information on completion results. These options entail building on the federal higher education reporting infrastructure (IPEDS) and initiatives to develop state-level longitudinal databases. An alternative approach could be replacing IPEDS with a national student unit record prepared by institutions and submitted to the

**TABLE 6: Performance Metric Policy Proposals and the Types of Metrics Used**

Policy Proposals	Metric Tiers Used			
	1. Access and affordability	2. Interim measures of student progress	3. Completion and credential attainment	4. Employment and earnings
Expand federal reporting on key measures of affordability, student progress, and completion and simplify existing disclosure requirements.	●	●	●	
Through the states, expand public reporting of program-level outcomes, including employment and earnings.			●	●
Create a national, voluntary Compact for College Completion.	●	●	●	

Department of Education. Congress has previously considered and rejected this option, so here we recommend options that improve data within the current reporting infrastructure and requirements, although we support further exploration of the national student unit record concept.

**PROPOSAL ONE:** Expand public reporting of institutional measures of affordability, student progress, and credential completion.

**DESCRIPTION:** Modify existing institutional reporting and disclosure requirements under the Higher Education Act to implement expanded public reporting that includes the addition of some new measures and shifts some existing measures from institutional disclosures to reporting requirements through IPEDS. Simplify existing Title IV reporting and disclosure requirements.

These modifications would consist of several elements:

- Expanded reporting by institutions to address data gaps for measuring access and success for low-income students, including: key measures of *institutional access and affordability* (from our Tier 1 group) such as percent receiving Pell Grants and other need-based financial aid (grants only), a measure of debt burden per student or graduate (Reed and Cochrane October 2012; Carey and Kelly 2011), and net price information; *interim measures of student progress* (Tier 2) such as developmental education course completion and progression in a program of study; and reporting of *credential and degree attainment rates* (Tier 3), using both the current definition of these rates and an expanded student cohort along the lines of

the recommendations of the Committee on Measures of Student Success (see Box 2).

- A stronger role for the Department of Education and the National Center for Education Statistics, including the development of common definitions and data elements and the development of comparable information on these measures. The Department of Education should make these results available for currently reported subcategories of students, such as gender and race/ethnicity, and for Pell Grant recipients and by enrollment status. This information should be made public through improved websites with better search capability so that results for key groups can be observed easily. Key measures should be included, as appropriate, on the Department of Education’s College Scorecard and Financial Aid Shopping Sheet.
- Modification of Higher Education Act requirements, changing to reporting requirements certain elements currently included as disclosure requirements. This would include, at a minimum, Pell Grant graduation rates, transfer policies, and data on cost.

- A full review of all existing Higher Education Act reporting and disclosure requirements within a year by the Department of Education, including input from institutions, the research community, and consumers, resulting in a report to Congress with recommendations for streamlining and simplifying these requirements.
- Exploration by the Department of Education of technical options for institutions to report required data in a more cost-effective manner than the current IPEDS process. This might include the option for institutions to replace some portion of the summary reporting requirement by submitting student-level data to a national clearinghouse, such as the National Student Clearinghouse. Another alternative would be to replace IPEDS entirely with a national student unit record system.

**DISCUSSION:** The Education Sector and the American Enterprise Institute surveyed 152 public and private four-year colleges and universities to assess the availability of required information under the Higher Education Act (Carey and Kelly 2011). The central finding was that “[t]he large majority of colleges are in total noncompliance with some of the most

## **BOX 2: Recommendations of the Committee on Measures of Student Success**

The U.S. Department of Education’s Committee on Measures of Student Success was authorized by the Higher Education Opportunity Act of 2008 to advise the Secretary of Education in assisting two-year, degree-granting institutions of higher education in meeting graduation rate disclosure requirements in the act. The committee can also recommend additional or alternative measures of student success that take into account the mission and role of two-year, degree-granting institutions. The committee developed recommendations in four areas:

- Broaden the coverage of student graduation data to reflect the diverse student populations at two-year institutions.
- Improve the collection of data on student progression and completion.
- Improve technical guidance to institutions in meeting statutory disclosure requirements.
- Encourage institutions to disclose comparable data on employment outcomes and provide incentives for sharing promising practices on measuring student learning.

widely cited provisions of HEA: those meant to focus attention on the struggle of low-income students to graduate from college.” This included provisions for collecting and reporting such data elements as the graduation rate for Pell Grant recipients, for which only 25 percent of sample institutions had publicly available information. Some type of employment placement information was provided by 67 percent of the institutions, but this largely consisted of “anecdotal information about the jobs and employers of recent graduates” for about 11 percent of the institutions. The report recommended the conversion of all HEA “disclose” requirements to “report” requirements so that the NCES can function as a central clearinghouse for comparable information.

Our proposal is consistent with the recommendations offered in the Education Sector/AEI report, while going further to require the addition of data on results for interim measures of progress and adding reporting of these measures by enrollment status, including always full-time, always part-time, and mixed enrollment status. Also, we recommend the addition of an expanded graduation rate that includes part-time students in the observed student cohorts, and that includes transfers and those substantially prepared for transfer in the numerator. These additional requirements would be balanced at least to some extent by potential reductions in the reporting burden that could result from the review of institutional disclosure requirements. We also believe that students need access to information about the employment and earnings of graduates, but we address this concern in Proposal Two.

The additional reporting requirements would enable the development of better profile information for colleges along the lines of the NCES College Navigator site or the College Portrait of Undergraduate Education developed for colleges participating in the Voluntary System of Accountability.<sup>34</sup> Further, these improved

profiles would include results for types of students that frequently encounter difficulty persisting in college and completing a credential. Such profile information should be provided through well-designed web interfaces that have multiple paths to information and that allow users to avoid extraneous material, while drawing their attention to important contextual elements.

The most significant disadvantage of this proposal is that it increases the reporting burden on colleges in two ways. First, colleges would have to submit additional data elements in their IPEDS reports that they now only must disclose on a website or at the request of a student. Second, the proposal includes additional data elements not currently reported or disclosed, including Tier 2 interim measures of progress, a broadened cohort of students in the graduation rate, and data on debt burden per individual (not just overall borrowing at an institution). While these added burdens are significant, the benefits of having this information are substantial, and a review of existing disclosure requirements may identify opportunities to reduce reporting burdens to at least partly offset the additional requirements. Such a review was recommended by the Advisory Committee on Student Financial Assistance (2011) in its study of federal higher education regulations. Institutions and the Department of Education could also explore producing IPEDS reports via a third-party clearinghouse, such as the National Student Clearinghouse, to ease the process.

**PROPOSAL TWO:** Require states to gather and disclose aggregate student employment and earnings for all programs of study.

**DESCRIPTION:** The Department of Education should build on existing State Longitudinal Data System grants to require states to develop a common definition of postsecondary program enrollment and standardized collection of data on certificate and degree attainment, so that students enrolled in and successfully completing programs of study can be

34 See: <http://nces.ed.gov/collegenavigator/> and <http://www.collegeportraits.org/>.

identified in a comparable manner.<sup>35</sup> This standard approach to defining program enrollment would most likely be based on student course-taking patterns rather than students' stated intent. In addition to comparable data on program enrollments and completions (Tier 3), the Department of Labor should build on existing Workforce Data Quality Initiative grants to require inclusion of UI earnings data (Tier 4) as part of longitudinal student records accessible through the State Longitudinal Data System. Education and Labor should work together with the states, building on efforts such as the Wage Record Interchange System to provide cross-state access to UI earnings data so that employment and earnings results for programs of study can be developed in a cost-effective manner that protects student privacy. Congress should include language in the appropriations for each department specifically authorizing access to these UI earnings data, notwithstanding other provisions of law. States should be required to submit these aggregate results to the Department of Education for use by NCES to expand institutional-level profile information to include employment and earnings results for all programs of study (not just occupational programs) and for all students, including those who complete a credential or degree and those who do not.

**DISCUSSION:** Access to usable information on the labor market results of program graduates and non-completers is a critical unmet need for all students, but it is particularly critical for low-income students and first-generation college goers. According to the Higher Education Research Institute's survey of freshman at bachelor's-degree-granting institutions, 86 percent of freshmen cited "to be able to get a better job" as a "very important" reason for deciding to go to college, followed by "to learn more about things that interest me" (83 percent), "to get training for a specific career" (78 percent), "to gain a general education and appreciation of ideas" (72 percent), and "to be able to make more money" (72 percent) (Pryor et al. 2011). The top five reasons cited by freshmen students for selecting the particular college

they were attending were: "very good academic reputation" (64 percent), "graduates get good jobs" (55 percent), "offered financial assistance" (44 percent), "a visit to the campus" (43 percent), and the "cost of attending" (41 percent). The top three objectives considered to be "essential" or "very important" for freshman survey respondents were: "being very well off financially" (80 percent), "raising a family" (73 percent), and "helping others who are in difficulty" (70 percent). Finally, the survey found that 72 percent of incoming freshmen agreed strongly or somewhat with the statement: "The chief benefit of a college education is that it increases one's earning power." This was the highest percentage among all such statements in the survey.

Evidence developed by Jennie Brand and Yu Xie (2010) suggests that those students who are the least likely to attend college due to socioeconomic barriers are the most likely to benefit from it in terms of subsequent earnings. Andrew Kelly and Mark Schneider (2011) found that when parents were "provided with graduation-rate data, 15 percent switched their preference to the school with the higher graduation rate." In addition, these effects were stronger among parents with lower educational attainment levels and lower incomes. A review of focus group studies of how students select colleges found that "the focus group findings with low-income, first-generation, and academically underprepared students were consistent with research on adult students in that these students also collapse the search and choice stages into one abbreviated step. They tend to focus on a single college or two, primarily due to cost considerations and the fact that their grades and test scores limit their choices" (MacAllum et al. 2007). For these latter students, having program-level data is especially important because it may help them expand the range of program and institutional options they explore.

Each of these research findings supports the idea that providing better information to students and parents on the labor market outcomes resulting from programs of study at individual institutions will improve the ability of students to select programs

35 For information on the SLDS, see: <http://nces.ed.gov/programs/slds/>.



and colleges that best meet their needs. Despite this, the availability of high-quality, comparable data on labor market results at the institution and program levels is very limited.

To address this issue, Senators Ron Wyden (D, Oregon) and Marco Rubio (R, Florida) have introduced the “Student Right to Know Before You Go Act” (S.2098). This legislation would provide for a statewide, integrated, individual-level, postsecondary data system that would include:

- All student components of reporting required for the IPEDS,
- Rates of remedial enrollment, credit accumulation, and postsecondary completion by high school completion status, and
- Information on average individual annual earnings, disaggregated by educational program, degree received, educational institution, employment sector, and state.

As was the case for Proposal One, this option could potentially be addressed via the development of a national student unit level record system to support the collection of student-level results by program and institution. In addition to the capture of data on individual student enrollment and completion results by program, a national student unit record would be matched with wage and income data to provide information on post-program earnings.

Our proposal is similar to the Wyden/Rubio bill in that it supports a state-level approach to the development of employment and earnings results. Other data requirements would remain a federal responsibility under IPEDS. Under this approach, states would have the primary responsibility for bringing the student records and UI covered earnings records together to permit measurement of student earnings over time. This is the model being followed under the State Longitudinal Data System and Workforce Data Quality Initiative grants. However, these grants lack the strong accountability features that are needed to ensure that states address the technical and political

challenges inherent in producing and publishing the earnings results. Strengthening these grant models by conditioning them on the accomplishment of clear progress benchmarks toward data sharing and reporting of results is needed. Inherent in this proposal is the recommendation that the SLDS and WDQI grants be continued as states develop sustainable funding models for these efforts, but that these grants be used to leverage the data matching, production, and sharing of summary results needed to implement this proposal.

Beyond the state-level role, a strengthened role for the departments of Education and Labor is also needed to provide overall direction and technical assistance. A clear statutory mandate is needed for these federal agencies to work together and to permit the states to share student and earnings information among states, drawing on National Student Clearinghouse and Wage Record Interchange System models as appropriate. The focus of this cooperation should be to link student data and employee data in a way that provides this vital earnings information while preserving individual and employer confidentiality. Such a federal-state cooperative model is more likely to find support in Congress and among states than a centralized data development model along the lines of the Gainful Employment regulations. In particular, the expansion of the scope for reporting earnings results to all programs and institutions, rather than for certain “occupational” programs as currently required for Gainful Employment, definitely raises the stakes for using this information: these employment results will become generally available, substantially increasing the ability of students to compare programs and institutions on these metrics. This also supports the case for a state-level approach, given the important differences among the states in how they structure and govern postsecondary education.

Under the expanded role for the Department of Education as described in Proposal One, the department could also support the development of college profile information that includes access to summary earnings data at the program level. Some

states (e.g., Virginia, Tennessee, Arkansas, and Florida) have undertaken the deployment of such information via the Internet, some working in collaboration with CollegeMeasures.org.<sup>36</sup> College Measures, a joint venture of American Institutes for Research and the Matrix Knowledge Group, focuses on using data to drive improvement in higher education outcomes. Its Economic Success Metrics Program assists states in making information about the earnings of graduates from their higher education programs publicly accessible.

U.S. Department of Labor-funded programs authorized under the Workforce Investment Act have had access to UI-covered earnings records for many years. This is because WIA specifically requires using this information in performance management systems and includes a provision authorizing access to the records for this purpose (Section 136(f)). Without similar language for postsecondary programs generally, the patchwork of variable access to these data will continue to exist across the states. Such data will be useful for more than improving students' career and college choices. The earnings results will be of interest to colleges as they develop and improve programs of study and career pathways, and they will be of interest to policymakers at all levels who seek to assess returns on the investment of public resources.

Disadvantages of this proposal include the increased reporting burden for colleges, although a well-designed system will minimize the effort required. A larger concern will be the confidentiality exposure risk that arises from the process of matching student records with UI earnings records on such a massive scale. Also, as noted, some states have restrictive statutes that must be addressed to allow this type of data matching. In addition, a state-level approach as proposed will inevitably result in differences from state to state, such as how programs and the enrollment of students into programs are defined, making cross-state comparisons less valid than would be the case under a national standardized model. Finally, earnings

data at the program and institutional levels could be misinterpreted and colleges compared on earnings results in inappropriate ways. These concerns can be addressed with careful design of the metrics and attention to the presentation of the data. While some disadvantages of this proposal may remain, they are outweighed by the potential benefits of giving students access to this critical information.

**PROPOSAL THREE:** Create a national, voluntary Compact for College Completion for students and colleges.

**DESCRIPTION:** The Compact for College Completion would provide additional funds and national recognition to students and colleges that agree to partner with the federal government on increasing completion. While the scope of the initiative would depend on available funding, the intent is to pilot the Compact for College Completion with a large number of students within selected colleges to increase the impact on each institution as a whole. Only students at Compact colleges would be eligible.

**COMPACT PARTNER ROLES AND RESPONSIBILITIES:**

- **Federal government.** The federal government would provide grants to students—Compact Scholars—and funding to colleges. It would also facilitate technical assistance to share research and promising practices among Compact colleges. In addition, the federal government, or an outside entity it contracts with, would monitor the extent to which each college is fulfilling its responsibilities as a member and would explore the feasibility of a rigorous evaluation of the pilot's effects on the completion rates of Scholars compared with similar students at each college. This feasibility study would include any recommendations for modifications in the design of the Compact that might be necessary for measuring results.
- **Students.** College Compact Scholars would receive a \$500 per semester Compact Scholarship, as long as they remain

<sup>36</sup> See: <http://www.collegemeasures.org/>.

continuously enrolled in college (whether full-time or part-time and excluding summers) and meet satisfactory standards for academic progress. In addition, Scholars would receive national recognition. Students who enroll in and make progress in a program of study within the first two years of college (as determined by the latest research on attachment to a program) would receive an additional Success Bonus of \$500.<sup>37</sup> Scholars would have to be enrolled in a Compact college, be income-eligible for Pell Grants (even if not eligible for other reasons), and have financial need as determined by the FAFSA. Student participation in the Compact could begin anytime after the first semester of college.

- **Colleges.** Colleges that join the Compact would receive \$500 each semester for every Compact Scholar enrolled at the institution and an additional \$500 completion bonus for every Scholar who ultimately completes. This funding structure rewards colleges for keeping Scholars continuously enrolled, for their progress, and for their completions. In exchange, Compact Colleges would track the progress of Scholars, provide regular feedback to them on their performance, and compare their progression and outcomes with cohorts of similar students. Colleges would also implement evidence-based approaches to improving completion for Scholars (with the Department of Education determining whether enough research exists to show that a particular approach a college proposes can increase persistence or completion).

Colleges would have to provide a 25 percent match for Compact funds. Some or all of the match could come from other federal sources, such as Perkins

37 A documented program of study could be either a major that is clearly aligned with requirements for further education at the next level or an occupational program with clear labor market demand or evidence of positive labor market outcomes. The full scope and sequence of this program of study should be laid out for the student. Attachment to a program of study would include enrollment in it and some measure of actual progress, such as completing three courses in the program.

Career-Technical Education funding, Workforce Investment Act funding, or Temporary Assistance to Needy Families, to the extent the college spends those resources on services or strategies that have shown evidence of increasing college persistence or completion. To be eligible to join the Compact, colleges must be public higher education institutions and use Compact funding to supplement, not supplant, existing institutional spending on student services and need-based financial aid, with compliance audited by the federal government. In addition, colleges would work with the Education Department's evaluator for the Compact to share publically what they learn about challenges to completion, institutional changes needed, implementation of change, and other lessons.

**DISCUSSION:** As noted, need-based grant aid increases access and persistence, and financial aid combined with other interventions—such as innovations in course delivery, curriculum or instruction, learning communities, financial incentives, extra academic support and advising, emergency transportation or child care aid, and others—may have an even larger effect (Scrivener, Weiss and Sommo 2012; Bettinger 2012; Deming and Dynarski 2009; Washington State Board for Community and Technical Colleges 2011). We conclude from this research that the Compact for College Completion is worth piloting, to see whether the impact of Pell Grants could be increased and the federal investment in them maximized if that grant aid were coupled with other evidence-based strategies for increasing persistence and completion. The pilot proposed here does not require colleges to adopt any single strategy: as the research in Section I noted, helping more students complete likely requires a combination of interventions. In addition, research finds that higher-performing community colleges have a strong institution-wide focus on improving student outcomes (Jenkins 2011). However, it does require that any intervention proposed by a Compact college have an evidence base showing it is likely to increase persistence or completion, as determined by the Department of Education.

For students in the Compact, our pilot would offer a financial incentive for remaining continuously enrolled. A landmark longitudinal analysis of student postsecondary progress and completion found a strong correlation between students' staying continuously enrolled and college completion: "Continuous enrollment is a factor of attendance patterns... It proves to be overpowering: with 16 other variables in play, continuous enrollment increases the probability of degree completion by 43 percent" (Adelman 2006). It is possible that selection bias accounts for these results; nevertheless, a forthcoming study from the Community College Research Center supports that thesis (Crosta 2013). The Compact would also reward students for enrolling in and making progress through a program of study because of evidence linking doing so within the first two years of college with higher rates of completion (Jenkins & Cho 2012).

For several reasons, our proposal does not require that students maintain a half- or full-time course load. First, low-income students sometimes must take smaller course loads in order to manage multiple roles as students, workers, and, often, parents (Kinsley and Goldrick-Rab 2011). Low-income students can themselves best judge how many courses they can take successfully in any given semester.

Second, most students who attend part-time some semesters attend full-time other semesters. A recent study from the National Student Clearinghouse found that 51 percent of undergraduates attend a mix of full and part-time vs. only 7 percent who attend exclusively part-time. After six years, 68 percent of those mixed enrollment students have completed or are still enrolled (Shapiro et al. 2012). These national data are consistent with earlier state studies,

which found that low-income students who attend less than half time some semesters average more than half-time course loads over their college careers (Washington Higher Education Coordinating Board 2006; Illinois Student Assistance Commission 2001).

An additional reason for not requiring a minimum course load each semester is that state budget cuts have resulted in thousands of students' being turned away from courses they need because not enough sections are offered. Given that Compact students will be attending exclusively public institutions, we do not want to risk penalizing them for circumstances beyond their control.

#### **ESTIMATED IMPACT ON THE FEDERAL BUDGET:**

Funding for the Compact could be found in revenue savings that result from simplifying existing tax-based student aid, as proposed in Section II. The scope of the pilot could be adjusted to fit available funding.

Federal policymakers are only beginning to grapple with the best ways to use performance metrics in higher education policy to advance key federal priorities. It is our belief that the framework presented here for considering potential uses for institutional performance metrics will contribute to a thoughtful discussion about what might be most appropriate. Our three reform proposals represent practical alternatives for: giving students and parents the information they need to choose wisely among colleges and programs of study, providing policymakers and institutions with data they can use to improve policy and practice, and creating partnerships that incent and support students and institutions to increase college completion.



## V. Conclusion



Any reform of federal student aid must address the twin challenges of college affordability and completion, which are inextricably linked. Here we have proposed ways to redirect existing federal student aid spending toward the low- and modest-income families who need it most. These are the students for whom federal aid makes a difference in whether they can enroll in college at all, and whether, once there, they can make school their primary focus, rather than having to work so many hours that completion becomes a receding, perhaps impossible, goal. Better information is also critical so that students and parents can make the best decisions possible about how to use financial aid. And reform should engage colleges and students to collaborate with the federal government on improving outcomes.

While there are political and fiscal challenges to reform, some solutions are clear. Federal tax-

based student aid is too complex and provides a windfall to many upper-income households whose college decisions do not depend on a federal deduction or credit. The revenue and income distribution estimates presented in this paper show that it is possible to simplify and better target this tax-based student aid to price-sensitive families and within a budget-neutral framework. Depending on the specific reform options chosen, it is even possible to greatly improve tax-based student aid and still save enough revenue to help stabilize funding for the Pell Grant program and fund innovation. Additional reforms, such as “real-time payment” of the American Opportunity Tax Credit and including college tax credits in the Financial Aid Shopping Sheet and other outreach efforts, would ensure that tax-based student aid is visible and accessible to families at the time they decide about college and pay college bills, not months later.



Much better and more usable college performance data are also part of the solution. Expanded college reporting on affordability, student progress, and completion would fill gaps in critical data needed by consumers. Filling these gaps also would help policymakers and colleges monitor results in order to improve policy and practice. Requiring states to gather and report completion, employment, and earnings outcomes for all postsecondary *programs* in their states would empower students and parents to see which local institutions offer the programs they want, and which have a record of the best results at

the most competitive prices.

Finally, colleges and students are essential partners in increasing college completion. Our national, voluntary Compact for College Completion would reward students and colleges for focusing on increasing completion and achieving results. Moreover, the additional federal resources from the Compact could support innovative strategies to support student success and ultimately change the way these colleges serve all students.

# Appendix 1: Revenue Estimates for CLASP Tax-Based Student Aid Options and Proposals

Improve the American Opportunity Tax Credit										
Calendar Year										
2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
<b>OPTION 1: Align the definition of qualified expenses with that used for Title IV student aid (all direct and indirect education expenses)</b>										
-7.3	-7.2	-7.1	-7.1	-6.8	-6.5	-6.2	-6.0	-5.7	-5.5	-65.4
<b>OPTION 2a: Refund 60 percent of the entire credit value</b>										
-1.7	-1.7	-1.7	-1.7	-1.7	-1.7	-1.8	-1.7	-1.8	-1.8	-17.2
<b>OPTION 2b: Refund 100 percent of the first \$1,000 of the credit value</b>										
-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3	-4.1
<b>OPTION 2c: Refund 100 percent of the first \$1,500 of the credit value</b>										
-2.2	-2.2	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.0	-21.0
<b>OPTION 2d: Refund 100 percent of the first \$2,000 of the credit value</b>										
-3.6	-3.6	-3.5	-3.5	-3.5	-3.6	-3.6	-3.5	-3.6	-3.6	-35.5
<b>OPTION 2e: Refund 80 percent of the first \$1,500 of the credit value</b>										
-1.1	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-10.5
<b>OPTION 2f: Refund 80 percent of the first \$2,000 of the credit value</b>										
-2.4	-2.4	-2.3	-2.2	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-22.9
<b>OPTION 3: Replace the four-year cap on AOTC with a lifetime maximum cap of \$10,000</b>										
Score not available.										
<b>OPTION 4: Index the American Opportunity Tax Credit for inflation</b>										
0.0	-0.1	-0.2	-0.3	-1.3	-1.5	-2.6	-2.9	-4.0	-4.2	-17.1

Simplify and Better Target Tax-Based Student Aid										
Calendar Year										
2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
<b>OPTION 5a: Begin phasing out AOTC income eligibility at \$140,000 and end eligibility at \$180,000 for married tax filers who file jointly. Begin the phase-out at \$70,000 and end it at \$90,000 for single tax filers.</b>										
0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.7	0.8	0.8	6.0
<b>OPTION 5b: Begin phasing out AOTC income eligibility at \$120,000 and end eligibility at \$180,000 for married tax filers who file jointly. Begin the phase-out at \$60,000 and end it at \$90,000 for single tax filers.</b>										
1.2	1.1	1.1	1.3	1.5	1.6	1.6	1.8	1.9	1.9	15.0
<b>OPTION 6: Do not renew the tuition and fees deduction</b>										
0.3	0.4	0.4	0.3	0.3	0.2	0.1	0.1	0.0	-0.1	2.0
<b>OPTION 7: Eliminate the Lifetime Learning Credit</b>										
0.8	0.9	0.9	1.0	1.0	1.1	1.3	1.3	1.4	1.6	11.3
<b>OPTION 8: Eliminate the student loan interest deduction</b>										
0.9	1.0	1.0	1.1	1.1	1.1	1.1	1.2	1.2	1.2	11.0

<b>Expand Outreach and Pilot “Real-Time Payment” of the American Opportunity Tax Credit</b>										
<b>Calendar Year</b>										
<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2013-2022</b>
<b>OPTION 9: Require more aggressive outreach to increase receipt of the AOTC</b>										
Score not available.										
<b>OPTION 10: Test voluntary “real-time payment” of the AOTC through a joint Treasury-Education pilot</b>										
Score not available.										
<b>OPTION 11: Add the AOTC to the Department of Education Financial Aid Shopping Sheet and require all Title IV institutions to use the Shopping Sheet</b>										
Score not available.										
<b>OPTION 12: Require expanded analysis by the Treasury Department of tax-based student aid data and take steps to link tax and financial aid data</b>										
Score not available.										

Reform Package Proposals										
Calendar Year										
2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
<p><b>PROPOSAL 1: Refund 100 percent of the first \$2,000 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; and eliminate the tuition and fees deduction, the Lifetime Learning Credit, and the student loan interest deduction.</b></p> <p><b>(Option 2d + 4 + 5b + 6 + 7 + 8)</b></p>										
1.2	1.3	1.3	1.4	0.3	0.4	-0.9	-1.0	-2.2	-2.4	-0.8
<p><b>PROPOSAL 2: Refund 100 percent of the first \$1,500 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; eliminate the student loan interest deduction and the tuition and fees deduction; and eliminate the Lifetime Learning Credit for graduate students only.</b></p> <p><b>(Option 2c + 4 + 5b + 6 + 7 (graduate students only) + 8)</b></p>										
1.8	1.8	1.8	1.9	0.8	0.8	-0.2	-0.6	-1.6	-1.8	4.8
<p><b>PROPOSAL 3: Refund 100 percent of the first \$1,500 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at \$120,000 and end at \$180,000 for joint filers and \$60,000 and \$90,000 for single and head of household filers; and eliminate the tuition and fees deduction and the Lifetime Learning Credit.</b></p> <p><b>(Option 2c + 4 + 5b + 6 + 7)</b></p>										
1.6	1.7	1.6	1.8	0.6	0.7	-0.2	-0.7	-1.6	-1.8	3.6



Other Revenue Estimates										
Calendar Year										
2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
<b>Eliminate the tuition and fees deduction and the Lifetime Learning Credit</b>										
2.6	2.7	2.8	2.8	2.9	3.0	3.2	3.3	3.4	3.5	30.2
<b>Replace the AOTC with the Hope Credit</b>										
11.7	11.8	11.7	11.9	11.8	11.9	11.9	11.4	11.3	11.2	116.6
<b>Option 5b + Option 6 + Option 7 + Option 8</b>										
4.7	4.9	5.0	5.2	5.4	5.8	6.0	6.2	6.5	6.7	56.4

**Notes:**

1. Preliminary estimates with the Tax Policy Center version 0412-8 with the 2012 education module. Current policy is assumed to be the current law with all tax-extender provisions scheduled to expire at the end of 2013, including Tuition and Fees Deduction, and the provisions of the American Recovery and Reinvestment Act of 2009 scheduled to expire at the end of 2017, including American Opportunity Tax Credit, to all subsequent years. See <http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3131> for the description of the current law baseline, and <http://www.taxpolicycenter.org/UploadedPDF/412730-Tax-Provisions-in-ATRA.pdf> for more detail of the American Taxpayer Relief Act of 2012 (ATRA) provisions and relevant provisions scheduled to expire at the end of 2013 and 2017. In particular, ATRA extended the American Opportunity Tax Credit to the end of 2017 and tuition and fees deduction to the end of 2013. Estimates include a microdynamic behavioral response, including changes in tax units' likelihood to claim education tax incentives.
2. The \$1,000 limit would be applied for each student. Under this proposal, a student eligible for \$1,500 of American Opportunity Tax Credit (AOTC) would qualify for \$1,000 refundable AOTC, compared to \$600 (40% of \$1,000) under the current policy. The remaining AOTC could then be used to claim non-refundable AOTC. It should be noted that, because the \$1,000 is applied at the student, no tax unit would be worse off under this proposal compared to the current policy.
3. The index is assumed to take effect starting in 2014, using 2013 CPI as the benchmark.



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