

Assessing Ability to Pay Under a Simplified System

Issue Paper Series, No. 3

June 30, 2009

NASFAA's Preliminary Recommendations from the National Conversation Initiative on Access and Aid for Student Success in Postsecondary Education (NCI) are a launch point for continued consensus building, support, and eventual enactment of changes necessary to eliminate the financial barriers to higher education. The NCI Issue Papers Series takes a deeper look at selected topics and provides additional insights on specific policy areas.



Measuring Financial Need or Eligibility?

How will financial aid administrators' jobs change under a simplified financial aid process? How can we continue to measure family contribution without the kind of data we are used to collecting? How will we make decisions about distribution of funds? If we no longer have an Estimated Family Contribution (EFC) to subtract from cost of attendance, what we will do instead? Isn't that formula –cost minus EFC—sacred? And if it's not…does that mean we have spent years believing in a measurement that never worked in the first place?

Of course not. That calculation still stands as the most precise, most reasonable, most accurate measure of a family's financial need. There is no more precise way to measure need than a system which derives a family contribution based on a full and complete assessment of family finances, and then deducts that contribution from costs at a specific institution to arrive at financial need.

But we have not been fully and completely assessing family finances for quite some time. The congressionally mandated formula eliminates consideration of important assets. The federal EFC formula ceased years ago to be, and is not now, an accurate measurement of need. It is a rationing device used to distribute limited funds against a pool of applicants.

Why then does NASFAA not advocate for restoring a precise and detailed measurement of need at the federal level? The data is in—data we did not have years ago—and it shows that regaining the precise detail that a full needs analysis would require would only serve to make the aid application system more complex, more intimidating than it is now, and would not, on a macro level, significantly improve the achievement of national goals of access and equity, and does little to encourage those for whom higher education is only a dream.

When it comes to assessing eligibility for Pell Grant—the cornerstone of our aid system—Dynarski and Scott said it best in "College Grants on a Postcard":

"How much does complexity help with targeting [funds to the right students]? The answer shocked even us. Out of more than 100 questions on the FAFSA, only a few have any substantial impact on grant eligibility. Dozens of questions contribute virtually nothing to the determination of grant aid. When we cut the number of items that go into the aid formula from seventy-two to fourteen ...there is virtually no change in the distribution of the Pell: it changes by less than \$100 for 77 percent of students and less than \$500 for 88 percent of students. . . The small shifts in aid eligibility that occur are highly progressive, with more money flowing to low-income families. Even if we go farther and throw out 90 percent of the questions used in the aid calculation, there is virtually no change in the distribution of the Pell . . . Effectively, the federal government

[already] has all the information it needs to determine Pell Grants, even if no application is filed at all."

NASFAA believes that there is still a place at the institutional level for true needs analysis—in fact, we think it is essential. On the federal level, however, as a matter of social policy that supports national goals, as a nation we gain much more than we lose by making higher education more accessible via simplification of the aid application. Web designers know that usability is key to keeping their users coming back. They also know that the default choices presented to a user are the greatest influencers of behavior. If we want to encourage generations of children to choose more education, we must not maintain a process so complex that the default becomes *not* choosing it.

Once a family knows where they stand in relation to the cornerstone federal programs, the main barriers to access have been removed. At that point, finer distinctions can come into play—such as a more rigorous and precise needs analysis by institutions should they decide to use such for their own or private programs. Federal student aid is only one part of the student aid system.

Envisioning a Simplified Federal Methodology

NASFAA's National Conversation Initiative (NCI) Preliminary Recommendations report demonstrates one way that we can start to think differently about measuring families' ability to pay, and we'll consider that approach in more detail in this paper. As is true of the NCI project in general, the scenario we propose here is not a prescription — only a launch point for discussion, debate, and further consideration.

In envisioning this alternate federal methodology, we kept the following principles in mind:

- Leverage existing tools and systems to the extent possible
- Generate a measurement methodology that could be easily understood by consumers, improving predictability with simple award look-up tables
- Define a student's need for funds in terms of the student's eligibility for a specified Federal Pell
 Grant amount. Under this paradigm, a relative measure of poverty, or index, is used to determine
 eligibility determination
- Consider the practical implications and potential challenges in implementation on college campuses

We started with the premise that "the federal government [already] has all the information it needs to determine Pell Grants." There's no doubt that some sort of linkage between federal income tax return data and the federal student aid system could significantly reduce the paperwork burden of the FAFSA. We

then asked how we could simplify eligibility determination too, so that families could plan ahead, knowing whether they are in likely to be in eligibility range or not. We looked to the system used for other means-tested federal programs for the answers.

Measurement of Poverty

The poverty line is the minimum level of income deemed necessary to achieve an adequate standard of living in a given country. When measuring a family's poverty level, we measure not what a family has, but what they do *not* have. In the U.S., poverty thresholds were originally developed in 1963-1964 by Mollie Orshansky of the Social Security Administration. The thresholds "are a measure of income inadequacy, not of income adequacy". Orshansky stated, "if it is not possible to state unequivocally 'how much is enough,' it should be possible to assert with confidence how much, on an average, is too little." (Gordon).

Today <u>poverty thresholds</u> are issued by the U.S. Census Bureau for statistical purposes — for example, for determining the number of persons in poverty and presenting data classifying poor persons by type of residence, race, and other social, economic, and demographic characteristics.

<u>Poverty guidelines</u> are a simplified version of the official statistical poverty thresholds often used for administrative purposes, such as determining whether a person or family is financially eligible for assistance or services under a particular federal program. They are issued by the U.S. Department of Health and Human Services and published in the *Federal Register* each year. In practice, the agencies administering these programs use the guidelines themselves and/or percentage multiples of the guidelines (for instance, 125 percent or 185 percent of the guidelines) as eligibility delimiters. These poverty guidelines form the basis of NASFAA's alternative approach to eligibility determination.

Some of the federal programs that use the poverty guidelines as an eligibility test include:

- Head Start
- Low-Income Home Energy Assistance
- Hill-Burton Free or Reduced Cost Medical Care
- Parts of Medicaid
- Medicare Prescription Drug Coverage
- State Children's Health Insurance Program (SCHIP)
- Family Planning Services
- Food Stamps
- Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)

- National School Lunch Program (for free and reduced-price meals)
- School Breakfast Program (for free and reduced-price meals only)
- Weatherization Assistance for Low-Income Persons
- Low-Income Home Energy Assistance Program
- Job Corps
- National Farmworker Jobs Program
- Scholarships for Health Professions Students from Disadvantaged Backgrounds
- Health Professions Student Loans (Loans for Disadvantaged Students)
- Senior Community Service Employment Program
- Low-Income Taxpayer Clinics
- Legal Aid Services

It is worth noting that some student aid programs administered by the Department of Health and Human Services (Scholarships for Health Professions Students from Disadvantaged Backgrounds and Loans for Disadvantaged Students) already use the poverty guidelines for eligibility determination. In addition, some federal entitlement programs –which NASFAA believes that the Pell Grant should become—use poverty guidelines for eligibility determination; these are Food Stamps, the National School Lunch Program, certain parts of Medicaid, and the subsidized portion of Medicare Prescription Drug Coverage. The guidelines are computed annually and are levered to the Consumer Price Index, thus including an adjustment for inflation.

The latest version of the poverty guidelines were published in the Federal Register on January 23, 2009, (see http://www.nasfaa.org/publications/2009/frhhs012609.html) and are shown in the table below:

Persons in family	Poverty guideline
1	\$10,830
2	14,570
3	18,310
4	22,050
5	25,790
6	29,530
7	33,270
8	37,010

Table 1 - 2009 Poverty Guidelines for 48 States and District of Columbia

For families with more than 8 persons, add \$3,740 for each additional person.

Income-to-Poverty Ratio as an Eligibility Indicator

NASFAA wanted to construct a scalable model using these guidelines that could apply regardless of funding levels and would maintain relative equity across a student population. The purpose of this model, while it does display our recommended eligibility cutoffs, is not to proscribe income levels at which Pell awards increase or decrease, but to grapple with the practical question of how the income-to-poverty ratio could function as a replacement of the EFC as the primary measurement of a family's ability to pay.

We began with some basic eligibility delimiters and strove to achieve a flexible model that would immediately identify which students had inadequate resources and remove them from further testing. Our delimiters were:

 Any dependent student whose parents are receiving means-tested benefits, or any independent student who is receiving such benefits, would automatically qualify for the maximum Pell Grant.

- In the case of independent students who have at least one dependent who is not a spouse, or the parents of dependent students, maximum Pell Grant eligibility is awarded to those who earn 200 percent of poverty level or less based on the number in their household. Those who earn between 200 and 400 percent of the poverty guideline would receive reduced Pell Grant amounts, with eligibility ending at 400 percent.
- Married independent students with no children or single independent students with no children
 would qualify for the maximum Pell Grant at or below 100 percent of the poverty guideline, and
 the minimum Pell Grant at 300 percent of the poverty guideline.

For federal student aid purposes, the depth of a family's poverty can be measured by the "income-to-poverty ratio." This is simply a measure of where a family falls in relation to the poverty guidelines chart. A family of four with an income of \$22,050 falls exactly at the poverty guideline for that family size; therefore, they are living at 100% of the poverty level. Another way of expressing this is as a ratio. Using the formula:

(Total Family Income/Poverty Threshold for the family size) = Ratio

produces an income-to-poverty ratio of 1.0 for this same family. A family of four with an income of \$65,000 has an income-to-poverty ratio of 2.9 as follows:

(65,000/22,050) = 2.94, rounded down to nearest ten

Assuming that the system would be using tax data or some derivative of it, the "number in family" used today would be replaced by number of exemptions.

We can now determine eligibility for federal student aid by comparing a family income-to-poverty ratio against the delimiters defined above.

• In the case of independent students who have at least one dependent who is not a spouse, or the parents of dependent students, those who earn 200 percent of poverty level or less based on the number in their household (i.e., have an income-to-poverty ratio of 2.0 or less) are awarded maximum Pell Grant. Those who earn between 200 and 400 percent of the poverty guideline (i.e., have income-to-poverty ratios between 2.1 and 4.0) would receive reduced Pell Grant amounts, with eligibility ending at 400 percent (ratio of 4.0).

• Married independent students with no children or single independent students with no children would qualify for the maximum Pell Grant at or below 100 percent of the poverty guideline (i.e., have an income-to-poverty ratio of 1.0 or less), and the minimum Pell Grant at 300 percent of the poverty guideline (i.e., have an income-to-poverty ratio between 1.1 and 3.0).

Note that this structure makes it possible to quickly identify the poorest of the poor—those living below the poverty line—because when income is lower than the guideline for a given family size, the formula automatically produces an income-to-poverty ratio of less than 1.0. This identifies those students for whom the existing system would have produced a negative EFC (should such treatment have been allowed) and can then be considered differently, if desired. It is also scalable in the sense that changing the outside boundaries of eligibility – as may need to happen to accommodate funding realities—does not require a change in formula but only a tweak to the amount of the delimiter.

The goal of this system is to produce an eligibility chart that is both simple to understand and can be given to students and parents, and extended for use by financial aid offices as well.

The NCI Preliminary Recommendations Report shows a sample chart that might be published for students; an annotated financial aid office version of a portion of the chart is shown below. It includes the factors used to calculate amounts and the relationship of the poverty ratio to percentage of maximum award.

If your family size is:	And your AC	GI is not more	e than:				
2	14570	30597	32054	33511	34968	36425	
3	18310	38451	40282	42113	43944	45775	
4	22050	46305	48510	50715	52920	55125	
5	25790	54159	56738	59317	61896	64475	
6	29,530	62013	64966	67919	70872	73825	
7	33270	69867	73194	76521	79848	83175	
8	37010	77721	81422	85123	88824	92525	
Income to Poverty Ratio	1.0	2.1*	2.2	2.3	2.4	2.5	etc.
Your Pell Grant is:	\$12,900	\$12,255*	\$11,610	\$10,965	\$10,320	\$9,675	
Percent of maximum award	100	95*	90	85	80	75	etc.

Table 2- Relationship of Income-to-Poverty Ratio to Pell Grant Award

There is a jump from a ratio of 1.0 to 2.1 in the first column because all students at or below 200% of the poverty level would qualify for a maximum award. Ratios are rounded down to the nearest ten.

This chart displays Income-to-Poverty Ratios in relation to the Pell Grant award amount for families of dependent students. The maximum award is set as a percentage of average national tuition and fees. Prorated Pell amounts are determined by stratifying a declining percentage of the maximum award across an increasing ratio of income to poverty.

Conclusion

This approach to computing eligibility using an "indicator" could be extended to campus-based programs as well. The ability to compare indices among students provides a ranking which, when packaging students in batch, works very well for determining relative need. Examples of using the ratio in campus-based based awarding processes are given in Appendix C2 of the NCI Preliminary Recommendations Report. Using the ratio doesn't, however, necessarily extend as easily to packaging a student on an individual basis. NASFAA presents these concepts as a basis for further discussion and exploration, and seeks your comments and ideas as we continue our National Conversation Initiative.

References

Dynarski, Susan and Judith Scott-Clayton. "College Grants on a Postcard: A Proposal for Simple and Predictable Federal Student Aid." Hamilton Project Discussion Paper 2007-01; KSG Faculty Research Working Paper Series RWP07-014, March 2007.

Fisher, Gordon M. "The Development and History of the U.S. Poverty Thresholds – A Brief Overview." U.S. Department of Health and Human Services. http://aspe.os.dhhs.gov/poverty/papers/hptgssiv.htm