THIRD WAY

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# Sharing the Risk for Students' and Taxpayers' Pell Grant Investment



**Wesley Whistle**
Former Education Policy Advisor
@WesleyWhistle

**Tamara Hiler**
Deputy Director of Education
@TamaraHiler

**Michael Itzkowitz**
Senior Fellow, Higher Education
@mikeitzkowitz


The federal government invests nearly $130 billion in higher education each year to ensure that Americans can get the degrees and skills they need to succeed in the 21st century. Because of this massive investment—and the poor results that investment too often yields at many institutions—there has been growing conversation about whether institutions, in addition to taxpayers and students, should have some "skin-in-the-game" for how well their students perform.[1] Better known as "risk-sharing," this concept has garnered bipartisan attention from lawmakers looking to increase institutions' responsibility for making sure students who enroll actually complete college and are prepared for jobs that will allow them to pay down their student debt. To accomplish this goal, newly proposed legislation would require institutions to pay the federal government back a portion of the federal loan dollars they received if a large share of their students are unable to begin repaying their loans after leaving school.[2]

While current risk-sharing proposals primarily focus on student loans and the risk students bear when they are unable to pay back their loans, most of this policy discussion fails to account for the nearly $30 billion dollars that flow to institutions through the Pell Grant program each year. Failing to hold institutions accountable for the massive Pell investment leaves taxpayers on the hook when an institution fails to serve its low- and moderate-income students well. That's why we believe risk-sharing proposals should look at the totality of student aid flowing to institutions of higher education, including both loans *and* grants.

## The Problem

**Institutions are Delivering Poor Outcomes for Pell Grant Students**

In the 2015-16 academic year alone, taxpayers invested nearly $30 billion in the Pell Grant program to help approximately eight million low-income students get a postsecondary education. [3] Yet, new data from the U.S. Department of Education shows that a large number of institutions have a pattern of failing to graduate students receiving Pell grants. At four-year institutions, only 49% of first-time, full-time students who received a Pell Grant graduated from that institution within six years of entering. [4] And even worse, institutions graduate their Pell students an average of seven percentage points lower than their non-Pell peers. In fact, in just a single year taxpayers paid over $7.6 billion in Pell Grants alone to institutions with Pell graduation rates (the rate at which students who are receiving Pell grants graduate) of less than 20%. [5] There's no doubt that our higher education investment is worth it—as college graduates stand to earn one million dollars more over their lifetime than high school graduates—but that benefit is reserved only for students who graduate. [6] By failing to hold institutions accountable for the success of their students receiving Pell Grants, we are letting down the students who are poised to reap the economic benefits of college the most. This is also a raw deal for taxpayers, as a lack of institutional accountability for Pell dollars means there are no safeguards to ensure that taxpayer dollars don't continue to flow to institutions that do nothing to provide increased economic mobility to the low- and moderate-income students they serve.

### Institutions Currently Bear No Risk for Poor Pell Performance

Sending Pell dollars to low-performing institutions with no accountability in return is not a responsible or fair way to steward $30 billion in taxpayer dollars. And not holding institutions accountable at all for their Pell outcomes also has implications for the students receiving Pell dollars. That's because students are only eligible to receive Pell Grants for twelve semesters. [7] Risk-sharing proposals that only hold institutions accountable for the loans students take out ignore the risk low- and moderate-income students take by using their limited Pell dollars to attend school, in addition to the opportunity costs of going to college (i.e. forgone income of working, time in the labor force, etc.). Right now, the only stakeholders poised to lose anything from poor Pell performance are taxpayers and students—leaving institutions with no consequences if they do nothing to help their Pell students succeed. Rather than having taxpayers write a blank check to institutions or allowing Pell recipients to use up their limited eligibility at schools with dismal outcomes, a risk-sharing proposal that also incorporates Pell Grant funding to institutions would give taxpayers and students protection for these dollars for the first time.

### A Loan-Only Approach Could Create Perverse Incentives

Lastly, risk-sharing proposals that only account for student loans may lead to some perverse incentives, such as having many low-cost institutions like community colleges end their participation in the federal student loan program. In 2016, nearly 1 million students attended nearly 234 community colleges that chose not to participate in the federal student loan program. [8] As we have already seen in other loan-only accountability systems like cohort default rate, many schools with fewer borrowers and lower tuition costs choose opt out of the loan programs entirely to avoid the threat of any penalty. But by not providing students with federal loans to cover non-tuition expenses like housing, books, and food, students may be driven to the less consumer-friendly private loan market. It can also scare off students from applying to school at all, or push them to work too many hours, putting them at further risk of dropping out. Installing a federal risk-sharing system that holds schools accountable only for their loan repayment rates or default rates could exacerbate this problem, ultimately shutting out more low- and moderate-income students from the higher education they need.

## The Solution

To ensure that institutions are held responsible for the totality of the investments they receive through the federal student aid program, we propose including the Pell Grant program as a part of any risk-sharing policy. If an institution fails to graduate its Pell Grant students, they should pay back a portion of Pell Grant funds received, as this demonstrates their inability to get adequate outcomes for this federally-funded group of students. In order to incentivize improvement, this policy should include a tiered set of repayment standards proportionate to student outcomes. We have seen all-or-nothing accountability systems fail to live up to expectations because no administration wants to cut off federal funds—which is effectively a death sentence for most schools. A sliding scale of taxpayer reimbursement makes it more likely that penalties will actually be imposed, and therefore, change institutional behavior. We propose that institutions should pay back a portion of the Pell Grants they received if Pell graduation rates fall below 20%, with larger payment requirements for graduation rates that fall below 10%.

Below is an example of how this solution could work. Our proposed risk-sharing formula creates a penalty based on the amount of Pell dollars an institution receives for Pell Grant students who entered but did not graduate. This method is fairer than other approaches because it accounts for the students who attend for different lengths of time—whether it be one or seven semesters—as well as the different amounts students receive.

## Possible Penalty formulas:

For institutions with <10% Pell graduation rates:

Penalty = Total Pell dollars of those Pell Grant recipients who didn’t graduate x 10%

For institutions with 10%-20% Pell graduation rates:

Penalty = Total Pell dollars of those Pell Grant recipients who didn’t graduate x 5%

**Penalty Reduction**

In order to make sure this policy does not create an incentive for institutions to enroll fewer Pell Grant students, any plan should also include a reduction in the penalty allocated to institutions based on the percentage of Pell students they enroll. Doing so will help mitigate those challenges faced at institutions that enroll a larger share of Pell students, while still acknowledging the role those institutions should be playing in the success of students. We propose the following penalty reduction for institutions based off the share of Pell Grant students that they enroll.

**Pell Reduction = (1-Pell share)**

**Final amount institution pays = Penalty x Pell Reduction**

As the formula demonstrates, the penalty amount would be reduced by the percentage of Pell students enrolled as a way to account for lesser resourced institutions taking a larger proportion of Pell students. However, that reduction should have a limit so that institutions aren't simply excused for abysmal student outcomes just because they enroll a large share of Pell students. For example, let's say an institution receives $1 million in Pell Grant funds, has a 20% Pell graduation rate, and has a student body that is made up of 10% Pell students, they would pay 90% of the penalty—equivalent to their share of non-Pell students—equal to $90,000.

## Institution A's Risk-Sharing Penalty:

Pell Grants Received ($1,000,000) x Penalty (20%) = $200,000 annual risk-sharing payment

Final payment = $200,000 x (90%) = **$180,000**

However, if a school has a 20% graduation rate but a 50% Pell share, they would pay only 50% of the penalty.

## Institution B's Risk-Sharing Penalty:

Pell Grants Received ($1,000,000) x Penalty (20%) = $200,000 annual risk-sharing payment

Final payment = $200,000 x (50%) = $**100,000**

Another possibility would be to create a tiered system for those institutions that fall below the average institutional Pell graduation rate. A penalty reduction could also weigh other factors, such as the percentage of students who are first-generation college students, the percentage of students with an Estimated Family Contribution (EFC) of $0, or even the percentage of students who received Free and Reduced Price Lunch in high school. This would help to more fairly account for the percentage of low-income students an institutions serves, as the Pell Grant is not a perfect proxy for wealth. You could also base the penalty reduction on the percent of *graduates* that are Pell recipients as a way to account for the share of Pell students. This would penalize those institutions who do well at graduating students but take very few students receiving Pell.

So where should this money go? Similar to some other risk-sharing proposals, we propose a Pell Improvement Fund where the money acquired from risk-sharing penalties would go to improve outcomes of Pell students at institutions that serve an above-average share of Pell students and need additional support to improve their graduation rates. This bonus could be targeted to those institutions who do not qualify for the penalty but have a below-average graduation rate. Those funds could also be targeted to low-resourced institutions generally and could also be used to restore Pell Grant eligibility to those students who don't graduate.

## Critiques and Responses

**A risk-sharing proposal that includes Pell Grant dollars could incentivize schools to stop enrolling Pell students.**

A concern of any risk-sharing proposal is the chance that institutions may avoid enrolling students deemed "riskier" in order to avoid any penalties. To mitigate this unintended consequence, this proposal reduces the risk-sharing penalty for underperforming institutions based on the percentage of Pell students served to account for the challenges of serving larger proportions of students from a lower socioeconomic status. Additionally, the money collected from any risk-sharing penalties could go directly into a fund to improve the outcomes of Pell students at schools with an above-average share of Pell students. We also suggest that this policy be only one part of a larger set of higher education reforms that improve opportunity outcomes for low- and moderate-income students and incentivize institutions to serve this population of students better.

**Different schools serve different kinds of Pell students.**

Data shows that factors outside of economic status play a role in students' long-term success, such as first-generation status or working full-time while attending school. Unfortunately, our current completion data has gaps, limiting our ability to see how various characteristics interact. For example, we can only see completion rates based on Pell status or race, not by Pell status *and* race. If better data were available, we could account for the nuances between various subgroups of students in a risk-sharing policy. However, regardless of the type of student, graduation rates of 10% or 20% are unacceptable. And if these students aren't graduating, they'll often end up with student debt and no college degree – a situation that leaves many worse off than before they initially enrolled.

**It's unfair to use graduation rates in a risk-sharing plan.**

We know there is concern with using graduation rates in any accountability system, as federal graduation rates have traditionally only included first-time, full-time students. For this reason, we recommend that risk-sharing policies use the Outcomes Measures graduation rates that will be released by the U.S. Department of Education in fall 2018, which will include part-time and transfer students rather than the typical first-time, full-time cohort. This graduation rate metric can exclude students who have transferred out, rather than counting them as non-graduates, as has traditionally been done. Additionally, the Outcomes Measure graduation rate is an eight-year rate, giving part-time students—including those at two-year schools—a very generous amount of time to enroll and complete their degree.

**Institutions can game the system and award low-quality degrees.**

With pressure to graduate students, there is a reasonable concern that institutions will lower their quality to hand out more degrees. But we do not foresee this proposal causing a race to the bottom where schools just churn out graduates and become diploma mills. First, there are several existing incentives to prevent this from happening, including schools being concerned about perceptions of quality among the public and the higher education community. Second, by setting a minimum floor for quality with a scale of increasing penalties for poorer performance, rather than a binary penalty of aid or no aid, the incentives for gaming are reduced. Finally, any proper accountability system must be made up of more than a singular metric to avoid easily gaming the system—hence the necessity to make this just one tool in the toolkit to encourage institutions to take greater responsibility for the outcomes of their students.

# Conclusion

Each year, taxpayers invest millions of dollars into the Pell Grant program in the hopes that it will boost economic mobility for the millions of low- and moderate-income students that access this financial aid each year. But far too often, institutions fail to graduate their Pell students and face no consequences for doing so. As policymakers consider new risk-sharing proposals that would require institutions to have some "skin-in-the-game" for the outcomes of the students they serve, they should consider the totality of the federal investment, including Pell Grants. And federal policy should acknowledge the risk students take by using their Pell eligibility at institutions that do not make them better

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## ENDNOTES

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