



# Pay It Forward

Refinancing Higher Education  
to Restore the American Dream



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## With thanks

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# Contents

Executive Summary.....	1
Higher Education Costs and Financing in Washington .....	2
<b>State cuts drive steady and steep tuition increases</b> .....	<b>2</b>
<b>With family budgets stagnant, students go deeper into debt</b> .....	<b>4</b>
The Pay It Forward Solution .....	6
<b>Description</b> .....	<b>6</b>
<b>Implementation and Funding</b> .....	<b>7</b>
Federal and Interstate.....	7
Statewide Options.....	7
Pilot Campuses .....	8
Medical School and the Health Professions .....	13
STEM Education.....	14
<b>Benefits of Paying It Forward</b> .....	<b>14</b>
Application and Attendance .....	15
Persistence .....	15
Career Choice.....	15
Pay It Forward versus Loan-based Financing.....	16
<b>Related Notes</b> .....	<b>17</b>
State Aid .....	17
Federal Aid .....	17
International Models for Income-Based Repayment.....	18
Additional Research Required .....	19
Appendices.....	20
<b>Appendix A: Method and Assumptions</b> .....	<b>20</b>
University of Washington and Green River Community College: Pay It Forward Models.....	20
<b>Appendix B: Pay It Forward and Other States</b> .....	<b>21</b>
<b>Appendix C: Washington State Financial Aid</b> .....	<b>21</b>
<b>Appendix D: Federal Financial Aid</b> .....	<b>30</b>
Federal Grants .....	30
Federal Loans .....	31
Federal Education Tax Benefits .....	33
<b>Appendix E: Australia: The Higher Education Contribution Scheme</b> .....	<b>33</b>
<b>Appendix F: The United Kingdom: Income-Contingent Loans</b> .....	<b>35</b>
Endnotes.....	37

# Executive Summary

Growing numbers of Washington's high school graduates are losing their shot at the American Dream, as the long-term decline in state funding for higher education – exacerbated by deep budget cuts during and after the Great Recession – pushes tuition costs out of reach for middle- and low-income families.<sup>1</sup> Facing stagnant household incomes, students and their families must either take on a mountain of debt or shelve plans to attend college. Both paths limit their potential economic mobility, and Washington's long-term economic productivity.

Meaningful employment in an occupation with good long-term prospects increasingly requires some form of postsecondary education – and the state's economic growth is highly dependent on developing a workforce ready for 21<sup>st</sup> century jobs. But the higher wages and greater economic mobility once made possible by a college degree are being undermined as families and students go ever-deeper into debt in order to afford college. Conversely, students unwilling to take out loans effectively lose access to the increasing number of jobs that require higher education.

It is time to radically rethink how Washington finances its public colleges and universities, so the American Dream stays within reach of every student willing to put in the time and effort to succeed in school. This report outlines such an approach, called Pay It Forward.

Under Pay It Forward, students pay no upfront tuition fees to attend college. Instead, they pay a small percentage of their adjusted gross income (AGI) for a number of years after college: 0.75% per year of community college, or 1% per year of university, for 25 years. Payments are placed in a trust fund that covers the cost for future students to receive the same opportunity to attend college with no tuition fees – hence, “Pay It Forward”.

This system has several advantages: First, it entirely removes up-front tuition barriers to attending college. Second, after the transition to Pay It Forward is complete, the system is not only entirely self-financing – it also supports successive net increases in college enrollment, making higher education both more affordable and accessible for succeeding generations of students. Third, by linking payments to students' ability to pay, Pay It Forward allows graduates to choose work based on their interests and skills, rather than solely on financial conditions. And finally, students retain access to federal financial aid to cover their cost of living, books, etc.

Pay It Forward could be implemented in one of several ways: statewide (using a large initial investment from a public or private source and subsequent allocations from the state budget or from a foundation); on pilot campuses (by converting existing state aid and accelerating inclusion of students); or in medical programs, covering the entire track of careers in the medical profession, from CNAs to RNs to PAs to MDs.

The trust fund itself can either be established at each institution or as a dedicated fund at the state level, and the exact percentage and number of years for repayment can vary depending on specific implementation, as well as type of degree (i.e. bachelor or associate).

While additional research and discussion with state policymakers, college administrators, students and other stakeholders is necessary, Pay It Forward has the potential to transform financing of higher education, making Washington's colleges and universities truly affordable and accessible to all.

# Higher Education Costs and Financing in Washington

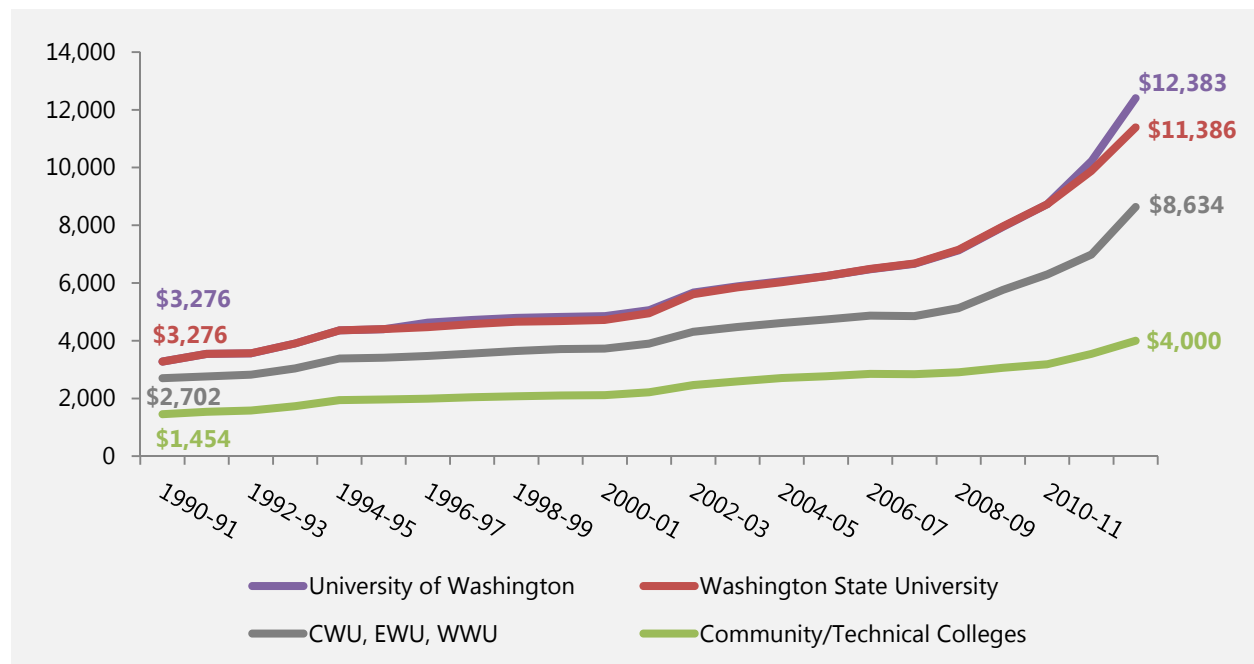
## State cuts drive steady and steep tuition increases

Thirty years ago, higher education was a public good accessible to all. In 1974, Washington’s Council on Higher Education declared that “access to higher education, regardless of economic means, is a basic commitment of the State of Washington” and so “student charges should be kept as low as possible consistent with the need to maintain a quality program of public higher education.”<sup>2</sup>

State legislators and college administrators once delivered on that commitment – but no longer. While the total cost of educating a postsecondary student has remained nearly flat since 1990, the state of Washington is funding an ever-shrinking share of that cost. The difference is being made up by tuition increases.

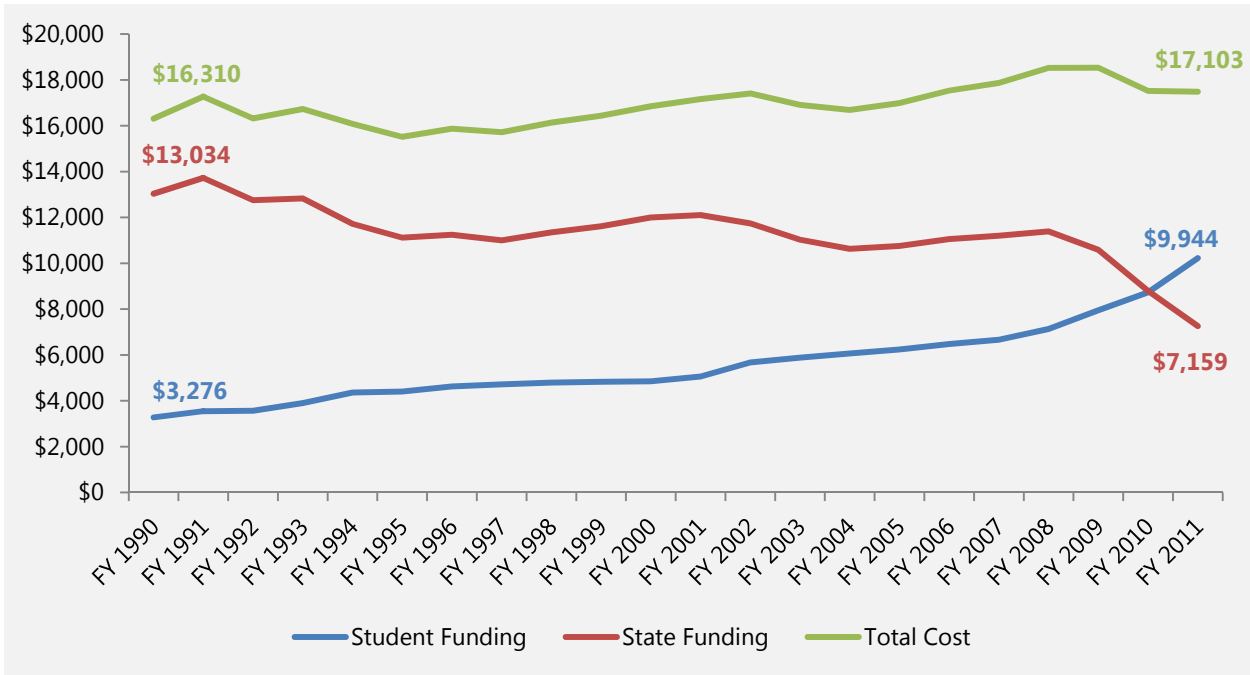
In 1990, full-time tuition and fees were \$1,454 a year at community colleges, and \$3,276 a year for the University of Washington.<sup>3</sup> Since then, tuition and fees have increased dramatically. Full-time tuition and fees will total \$4,000 per year at Washington’s community colleges in 2012-2013.<sup>4</sup> At the University of Washington, tuition and fees total will total \$12,383 next year, more than three times that of 1990.<sup>5</sup> (All amounts are in today’s dollars.)

**TUITION AND FEES, WASHINGTON STATE COLLEGES AND UNIVERSITIES, 1989-2012**



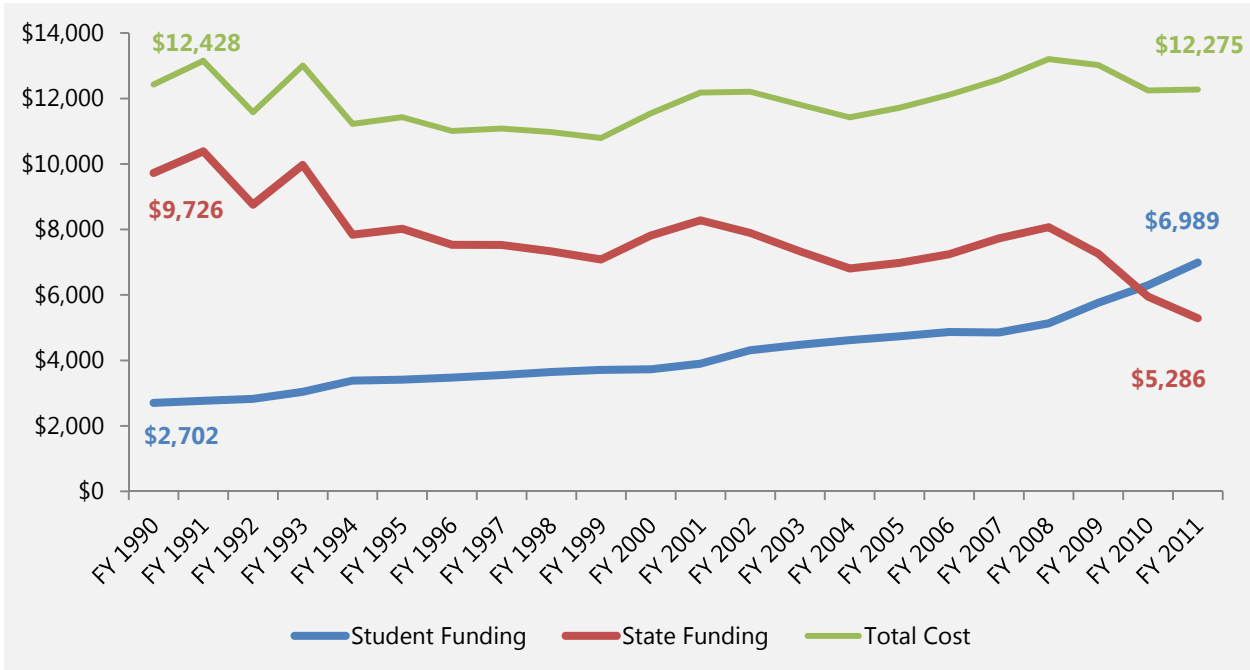
Source: Washington State Student Achievement Council (formerly the Higher Education Coordinating Board).<sup>6</sup> Amounts shown in today’s dollars.

**SHARE OF STATE VERSUS STUDENT FUNDING: UNIVERSITY OF WASHINGTON**



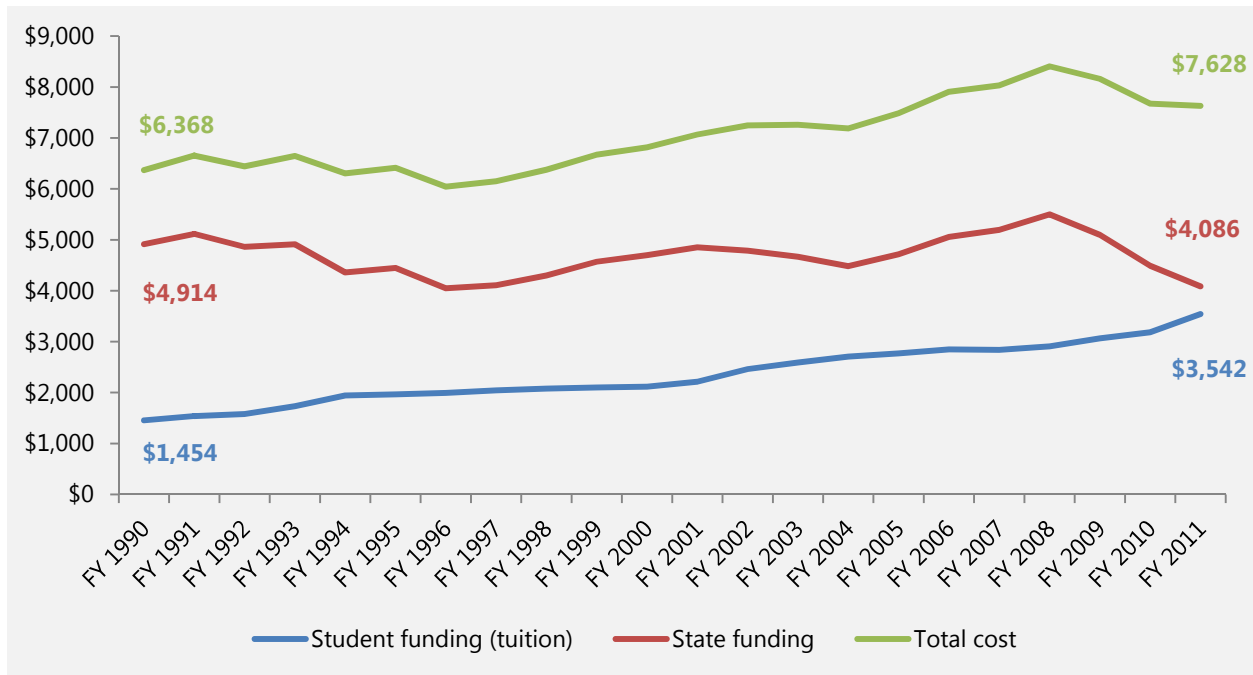
Source: LEAP and Washington Student Achievement Council (formerly Higher Education Coordinating Board)

**SHARE OF STATE VERSUS STUDENT FUNDING: WASHINGTON COMPREHENSIVES  
(AVERAGE OF EASTERN, CENTRAL AND WESTERN WASHINGTON UNIVERSITY)**



Source: LEAP and Washington Student Achievement Council (formerly Higher Education Coordinating Board)

## SHARE OF STATE VERSUS STUDENT FUNDING: WASHINGTON COMMUNITY COLLEGES



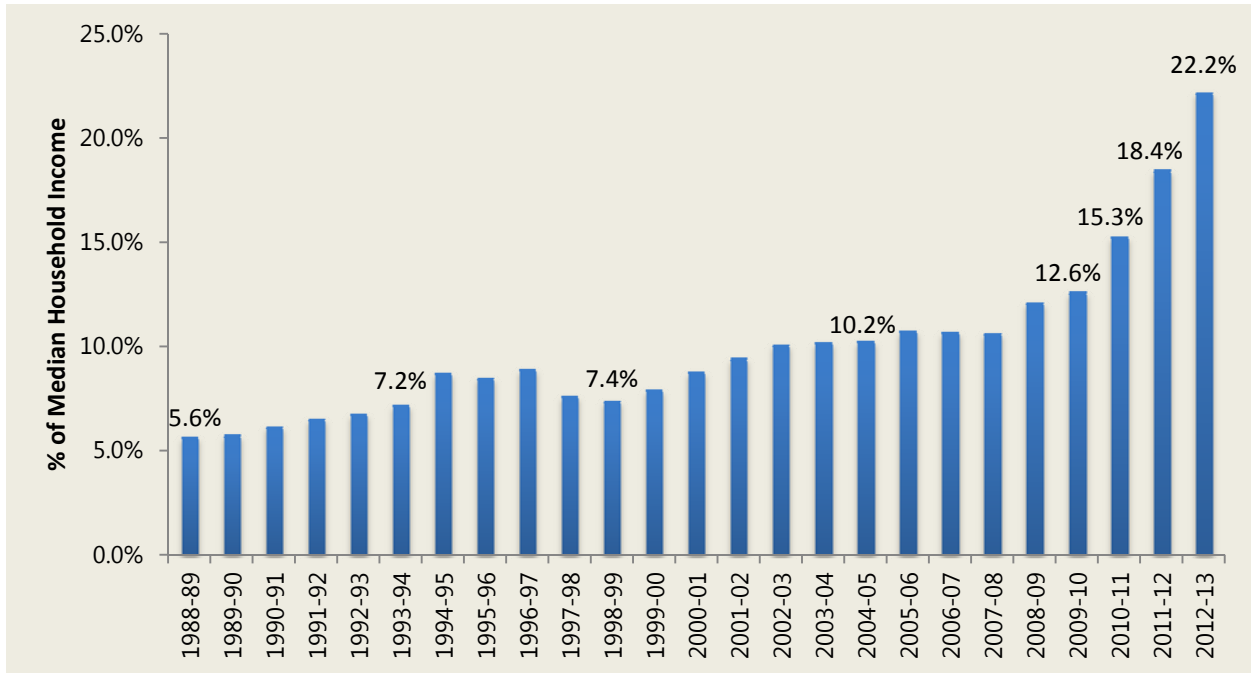
Source: LEAP and Washington Student Achievement Council (formerly Higher Education Coordinating Board)

### With family budgets stagnant, students go deeper into debt

Washington's students and their families are facing ever-higher prices for public colleges and universities, while at the same time median household income has largely stagnated – up just 5% since 1990. Loans help lower the initial hurdle, but they also prolong the financial burden on families' and graduates' wages – and the lower one's income, the bigger the burden. Those who take longer to repay loans accrue more interest and pay more for college as a result.

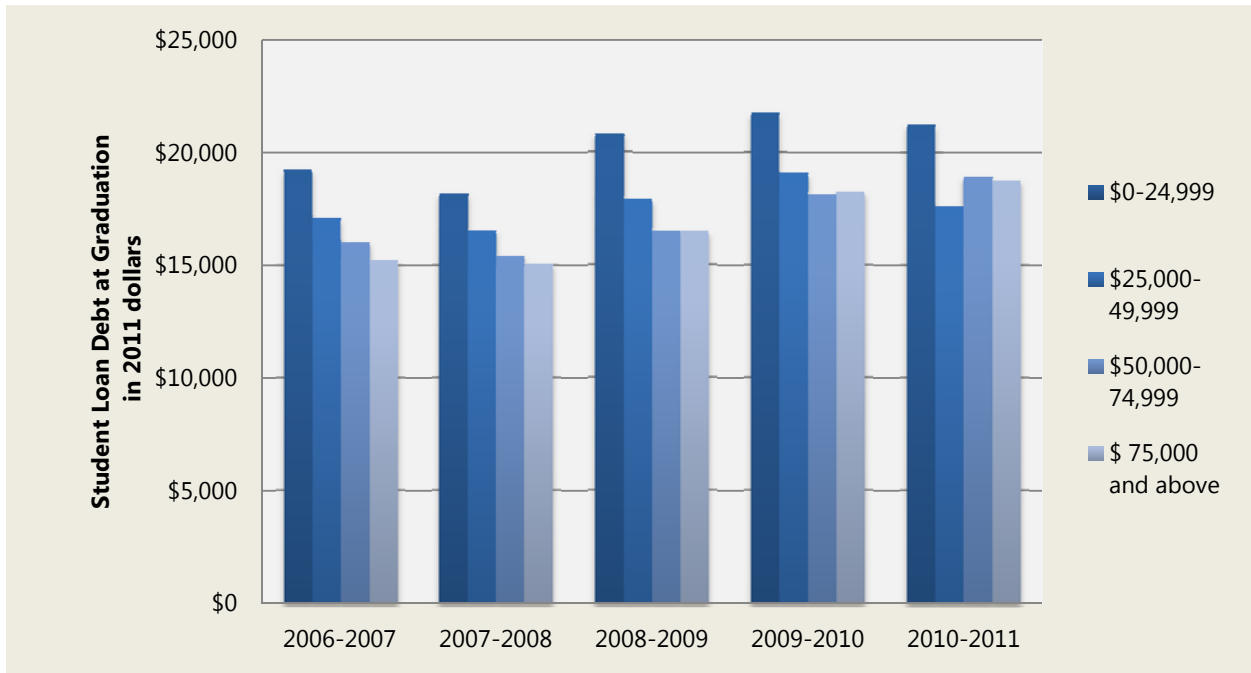
Even before interest accrues, educational loan debt is the largest for students whose families earn the least. In 2011, resident undergraduate borrowers from families who earn less than \$25,000 graduated from the University of Washington with an average of \$21,256 in debt. Comparatively, student borrowers whose families earned over \$75,000 a year graduated with an average of \$18,789 in debt. However, the gap between income quartiles has been decreasing since 2006, as students from all income quartiles are taking on greater debt to cover rising tuition fees. At the UW, the average loan debt for high-income students has nearly reached the level of low-income student debt from just five years ago.

**UNIVERSITY OF WASHINGTON TUITION  
AS A PERCENTAGE OF WASHINGTON MEDIAN HOUSEHOLD INCOME**



Source: US Census Data, 2010.<sup>7</sup>

**AVERAGE STUDENT LOAN DEBT BY INCOME  
FOR UNIVERSITY OF WASHINGTON STUDENTS WHO GRADUATE WITH DEBT, 2006-2011**



Source: University of Washington Income/Debt Comparisons, 2006-2011.<sup>8</sup>



# The Pay It Forward Solution

## Description

Pay It Forward keeps public higher education within reach of every student who is willing to put in the time and effort to succeed by fundamentally restructuring how the state finances higher education. Under Pay It Forward, students can attend a community college, regional college or research university without paying any tuition or fees up-front. Removing this price barrier:

- improves college access for low-income and middle class students, who might otherwise be deterred from attending or completing college by the prospect of high debt levels;
- allows graduates to choose work based on their interests and skills, rather than solely on financial conditions; and
- retains student access to federal financial aid to cover their cost of living, books, etc.

In return, the students sign a binding agreement to pay a certain percentage of their annual adjusted gross income (AGI) to a social insurance fund (managed by the state, or by the specific academic institution). This ties students' payments to their incomes, making higher education accessible and affordable to all. It also preserves higher education as a public good by ensuring future generations of students have the same opportunity to attend college with no up-front tuition cost – hence the name “Pay It Forward”.

Pay It Forward (PIF) is not a loan program that requires repaying a predetermined sum with interest to a bank or the government. Instead of making loan payments with interest, graduates are legally bound to make Pay It Forward contributions as a percentage of AGI over a fixed period of time. The stipulations of these agreements can vary according to:

- total cost of education and/or type of degree (bachelor or associate), depending on the institution;
- portion of the cost that is designated as a public responsibility and assumed by the state;
- duration of years of payment; and
- percent of adjusted gross income (AGI) used to calculate payment.

Several variations on contribution plans are possible. A graduated system of percentages of AGI could be built based on the total number of quarters of school attended. This would enable a student to pay only for the actual credits for which they enrolled. For example, in one possible scenario a student would agree to pay 0.75% of AGI for each year of community college, over a period of 25 years.

After the transition to Pay It Forward is complete, the system is not only entirely self-financing – it also supports successive net increases in college enrollment, making higher education both more affordable and accessible for succeeding generations of students.

## Implementation and Funding

### Federal and Interstate

Implementing Pay It Forward at the federal level would enable funding unbound by state balanced budget restrictions. It would also facilitate tracking graduates and collecting their PIF contributions through the IRS 1040 and W-2 forms.

As an intermediate-scale development, it may be more pragmatic to develop this proposal as a compact between several states that are ready to move forward. This constellation of states could include small states (Vermont, Rhode Island), larger states (New York, California), and medium sized states (Washington, Oregon, Connecticut, Iowa, Massachusetts, and Minnesota, for example).

### Statewide Options

There are several options for implementing Pay It Forward on a large scale in Washington. The first alternative is to make PIF an immediate, universal program including all students in public universities, colleges, and community colleges across the state.

If all enrolled first year students in Washington's public universities, colleges, and community colleges were to be simultaneously included in Pay It Forward, we estimate that the first year costs would be about \$600 million, net of current financial aid, and assuming no decrease in current state support for public higher education.

As students of all college years (1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> year students) are brought into the system, costs increase. The estimated cost for Year 4 would be about \$1.6 billion. After 4, as contributions are accumulated in the trust fund, annual costs drop. By Year 13, total net annual cost would decline to \$1 billion, by Year 20 cost would drop to \$500 million, and by Year 25 there would be no net cost. Each year following, PIF would generate enough revenue to support increased student enrollment.

Possible sources of funding for this option include:

- a time-limited source of either private or public money (or both);
- a contribution from private foundations interested in increasing access to higher education (such as the Gates Foundation and the College Success Foundation);
- a specific new and dedicated public funding source;
- a bond against anticipated streams of revenue (although this approach decreases the funding available for financing the program in the long term); or
- a combination of these sources.

A second, more incremental alternative is to use current state and college student aid funds to slowly build Pay It Forward.

State financial aid totaled \$285 million in 2011-2012.<sup>9</sup> Starting with a cohort of students benefitting from state financial aid, Pay It Forward graduates will generate new additional revenue enabling more students to be a part of PIF. (Assuming funding for financial aid remains constant and tuition is stabilized.)

Beginning the transition with incoming students would make it possible to use existing funding in all state public universities, colleges, and community colleges for Pay It Forward, growing it gradually but significantly, and accelerating over time.

After ten years, the number of PIF students will have increased by 50%. Within 20 years, the number of students on PIF may be tripled. The actual trend will be dependent on the cost of tuition, the post-graduation salaries of PIF students, and the ratio of students graduating from community colleges and four-year public colleges.

### State funding for higher education under Pay It Forward

Pay It Forward will significantly change the way students contribute to the cost of public higher education – but it cannot replace existing public support from the state legislature. In order for Pay It Forward to deliver affordable and accessible higher education for Washington’s students, the state must maintain a base level of funding for its colleges and universities – preferably about two-thirds of the total cost of higher education, equivalent to state higher education funding just five years ago (FY 2007).

If the state’s contribution to higher education is zero, then Pay It Forward contributions must be extended to at least 30 years and the contribution rate increased to 5% of income for four years of college, making total costs to students and families higher than what they now face with the current loan-based financing model.

### Pilot Campuses

Pay It Forward could also be implemented in a variety of geographic contexts, depending on political will and available start-up funds. This model could be tried in a micro-simulation, by targeting a research or regional university and one or two community colleges.

Based on this approach, we have developed two models for implementing Pay It Forward at the University of Washington and at Green River Community College. Other possible pilot sites include Big Bend Community College (Moses Lake), Walla Walla Community College (Walla Walla), Central Washington University (Ellensburg), Eastern Washington University (Cheney), or Evergreen State College (Olympia).

### The University of Washington: From Husky Promise to Pay It Forward

As the University of Washington (UW) has increased tuition, it has also created the “Husky Promise” program. Husky Promise guarantees free tuition for almost one-quarter of UW students. Students who qualify, and are eligible for the federal Pell Grant or the Washington State Need Grant, receive additional funds to cover their unmet needs up to the total cost of tuition and fees.

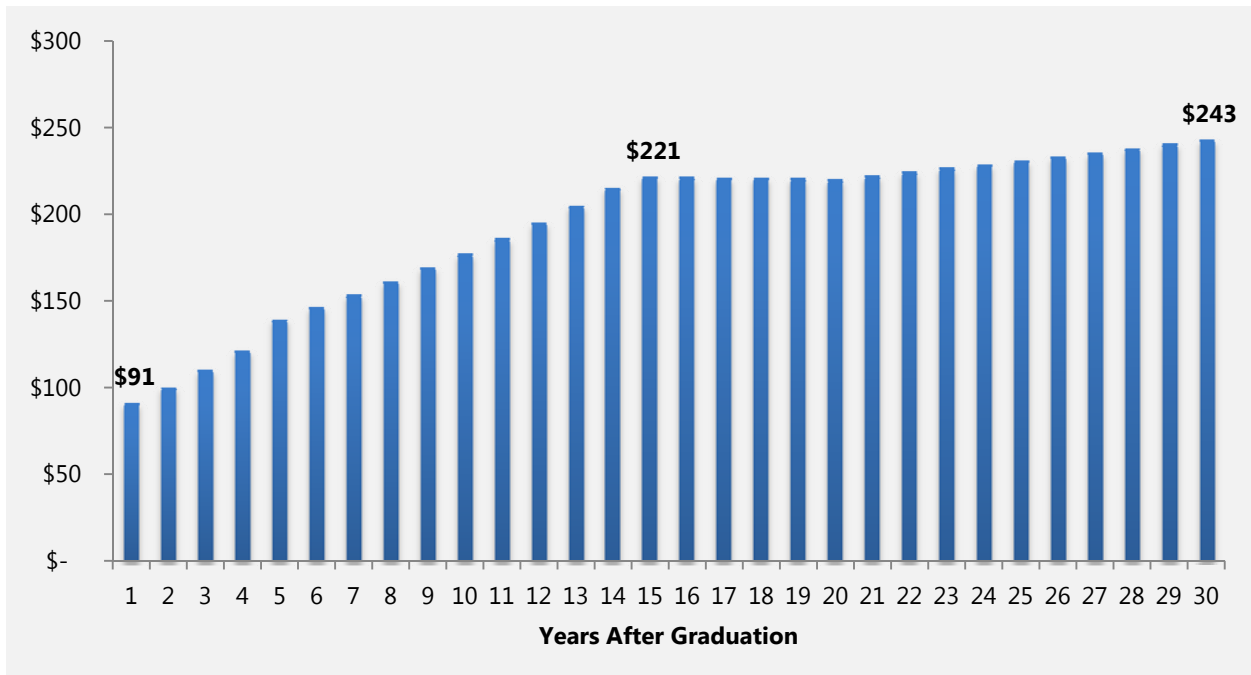
Husky Promise is now available only to the lowest-income students – about 25% of the undergraduate student population – but it could be gradually transformed to create a comprehensive Pay It Forward solution for all students.

Under this model, a Husky Promise/Pay It Forward student would still attend UW without paying upfront tuition. In return, the student would sign a binding agreement to contribute 1% of her adjusted gross income (line 37 of the IRS 1040 form) for each year of attendance (i.e., 4% if graduating in four years), for a period of 25 years.

#### MEDIAN INCOME AND PROJECTED PAY IT FORWARD CONTRIBUTIONS FOR BA GRADUATE

	1 year post-graduation	10 years post-graduation	20 years post-graduation
<b>Median income for Bachelor of Arts graduate</b>	\$27,275	\$53,103	\$65,965
<b>Yearly Pay It Forward contribution (4%)</b>	\$1,091	\$2,124	\$2,639

## UW HUSKY PROMISE/PAY IT FORWARD CONVERSION: INDIVIDUAL MONTHLY CONTRIBUTIONS



Source: Based on LEAP Budget Office data, 2012 <sup>10</sup>

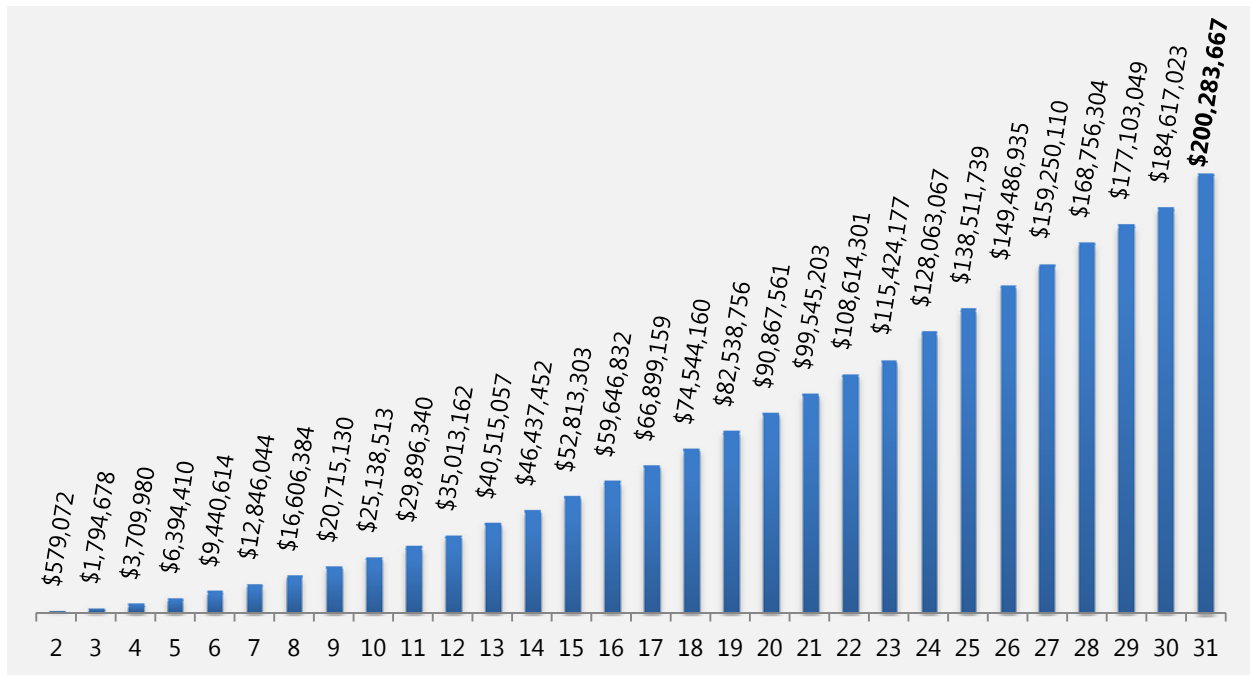
These individual contributions combine to create a new and growing revenue source which enables an increasing number of students to access higher education without paying upfront costs. In the very first year after graduation, students (who will have participated in Pay It Forward for just one year before graduation) will generate \$579,000 in additional revenue – enough to pay for 53 new students, thus growing the Pay It Forward cohort from 8,500 students to 8,553.

Each new graduating class will increase Pay It Forward revenue above its original baseline. The second graduating class will contribute 2% (1% for each year); the third, 3%; and the fourth and all following classes will contribute 4% – all for a period of 25 years.

The resulting funding stream will generate over \$200 million in added annual revenue by the 31<sup>st</sup> year of Pay It Forward. This will enable 27,000 students to participate – fully two-thirds of all undergraduates at the UW.

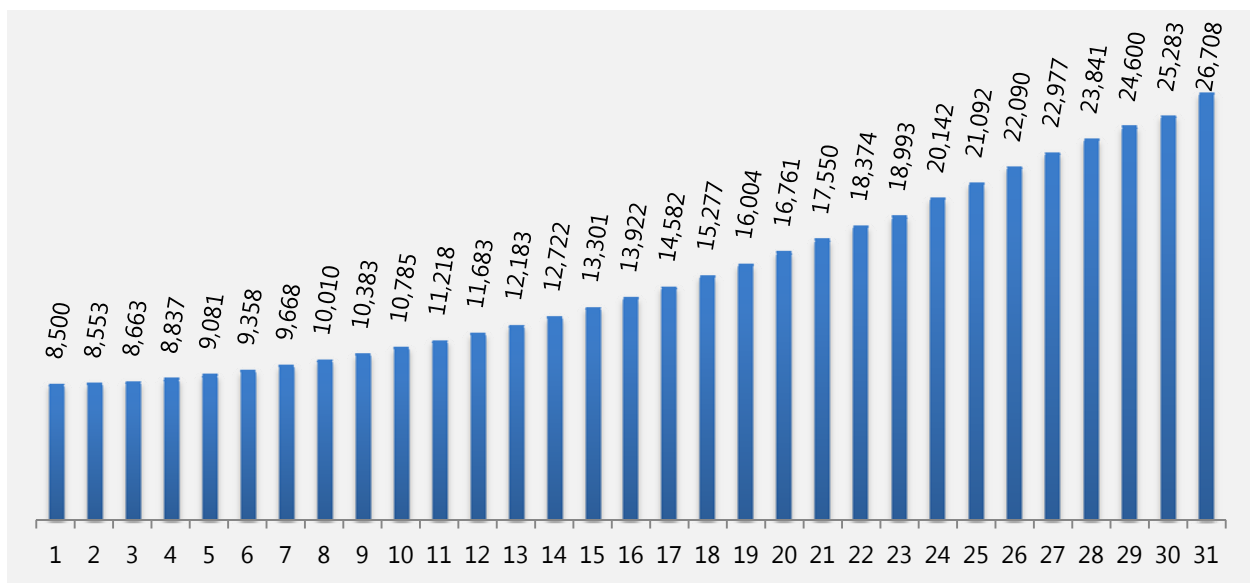
By gradually increasing enrollment in Pay It Forward, the UW and the state take on no additional costs for transitioning to this new funding system. Instead, the system gradually incorporates more and more students. It also enables the continuation and integration of current funding mechanisms, such as GET credits, even as Pay It Forward incorporates more and more students. In this way, Pay It Forward makes it possible to fully fund tuition costs for all UW students within the next forty years at no additional cost to the state or UW.

## PAY IT FORWARD UW HUSKY PROMISE CONVERSION: ANNUAL ADDED REVENUE



Source: Based on LEAP Budget Office data, 2012.<sup>11</sup>

## PAY IT FORWARD UW HUSKY PROMISE CONVERSION: GROWTH IN NUMBER OF STUDENTS



Source: Based on LEAP Budget Office data, 2012.<sup>12</sup>

### Pay It Forward at Green River Community College

Tuition at Washington's community colleges has skyrocketed 250% since 1989. In the last decade alone, tuition has increased \$1,800, or more than 80%. Green River Community College has responded by increasing financial assistance: in 2010-11, 5,236 students received \$18.5 million in financial aid, a 20% increase from the previous year. Of total financial aid from 2010-2011, one-third comes from state, local, and college sources, and two-thirds from the federal government.

However, financial assistance is available primarily to low-income students, leaving many students from middle-income families with daunting costs for tuition. Implementing Pay It Forward would benefit both low- and middle-income students, by enabling them to attend Green River Community College with no up-front cost.

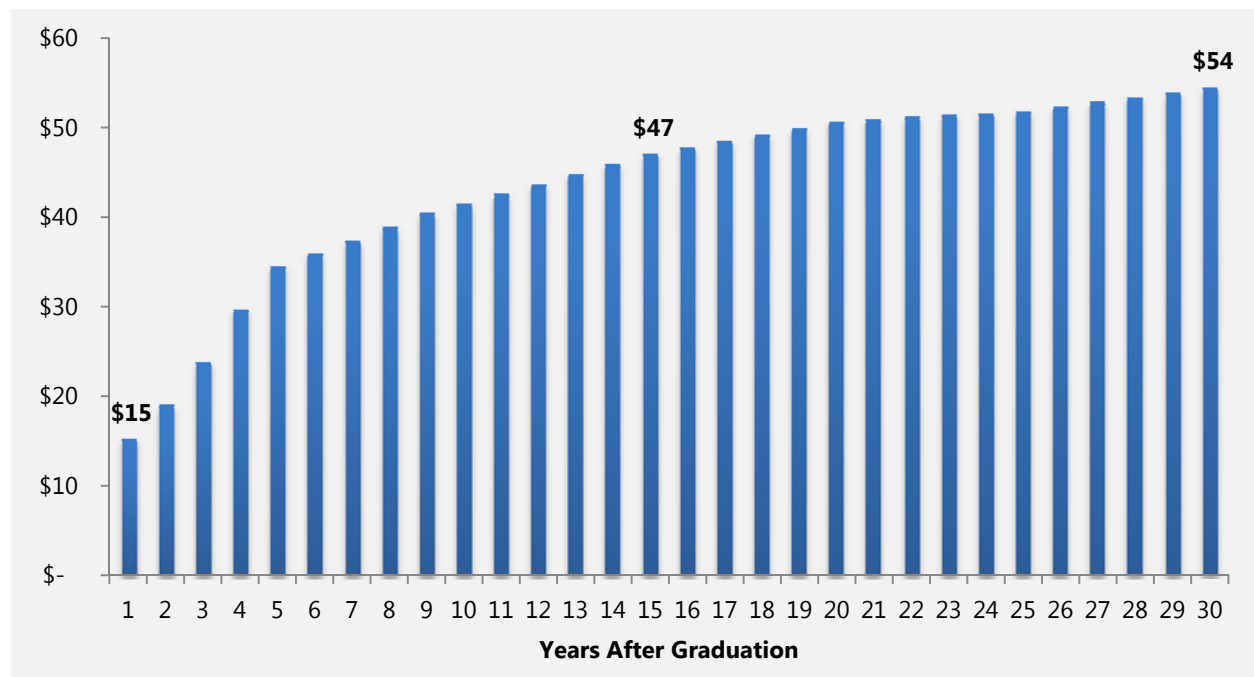
Community college students pursue professional and technical degrees. These students attend community colleges under the understanding that their wage increase after graduation will be a return on their educational investment. For them, a payment method that is proportional to this benefit makes the most sense. Additionally, the 1.5% of AGI paid by community college graduates offers an incentive for non-traditional students to pursue higher education.

Under Pay It Forward, a Green River Community College student would attend school without the barrier of escalating tuition. In return, the student would sign a binding agreement to contribute 0.75% of adjusted gross income for each year of attendance (i.e. 1.5% if graduating in two years), for a period of 25 years.

### MEDIAN INCOME AND PROJECTED PAY IT FORWARD CONTRIBUTIONS FOR AN AA GRADUATE

	1 year post-graduation	10 years post-graduation	20 years post-graduation
<b>Median income Associates Degree graduate</b>	\$12,163	\$33,246	\$40,511
<b>Yearly contribution (1.5%)</b>	\$182	\$499	\$608

### PAY IT FORWARD AT GREEN RIVER COMMUNITY COLLEGE: INDIVIDUAL MONTHLY CONTRIBUTIONS

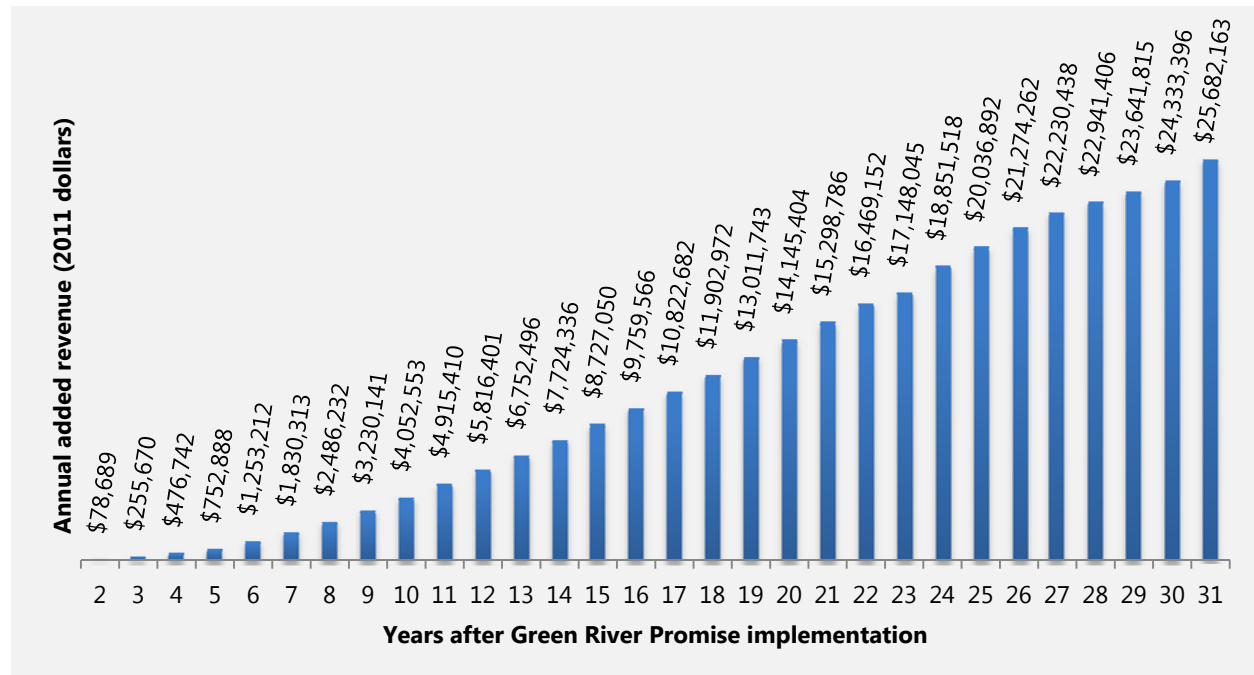


Source: Based on LEAP Budget Office data, 2012.<sup>13</sup>

In the first year after implementation, students (who will have participated in Pay It Forward for just one year before graduation) will generate \$79,000 in additional revenue – enough to pay for 22 new students, growing the Green River Community College Pay It Forward cohort from 1,727 students to 1,749.

Each new graduating class will increase Pay It Forward revenue above its original baseline. The second class and all following classes will contribute 1.5%, for a period of 25 years. The resulting funding stream will generate almost \$26 million in added annual revenue by the 31<sup>st</sup> year of Pay It Forward. This will enable 8,861 students to participate by Year 31, 700 students more than current full-time enrollment at Green River.

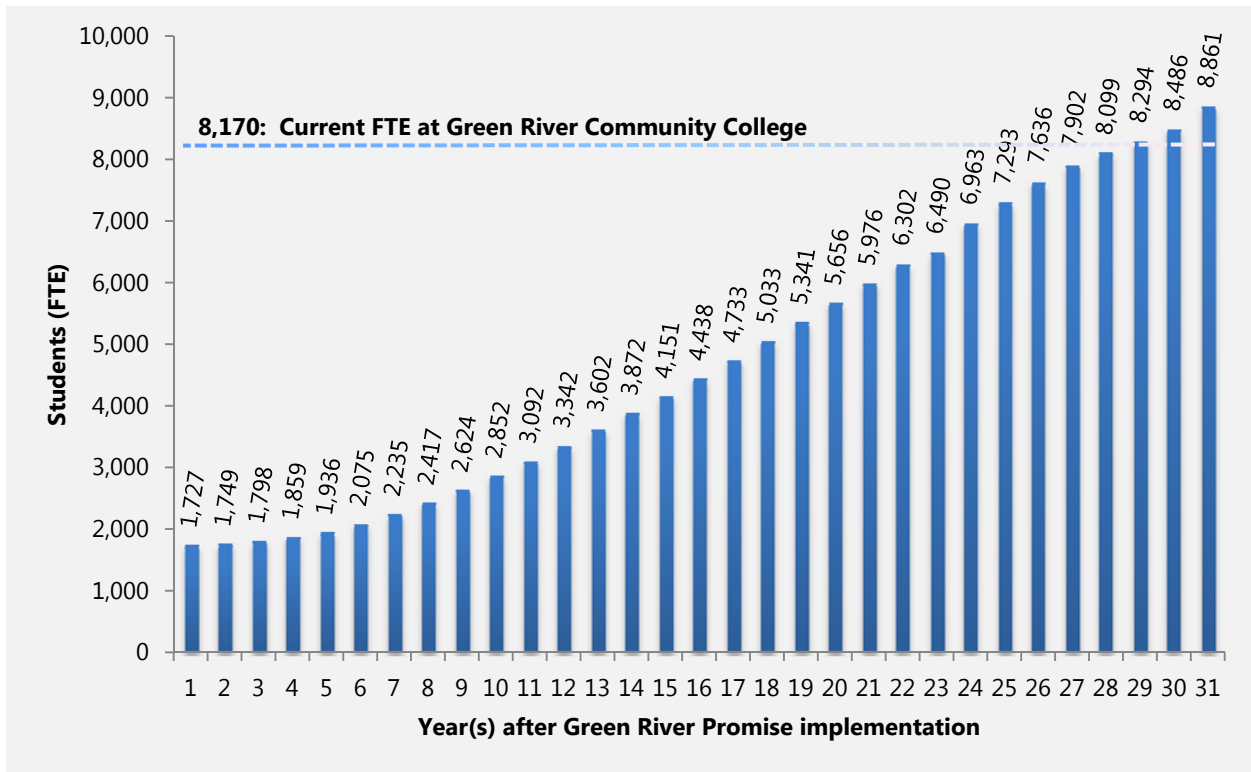
### PAY IT FORWARD AT GREEN RIVER COMMUNITY COLLEGE: ANNUAL ADDED REVENUE



Source: Based on LEAP Budget Office data, 2012.<sup>14</sup>

These calculations assume no change in current levels of state funding for higher education. However, increases in Pay It Forward participation would be quicker if the Legislature were to restore funding for public higher education to what it was just ten years ago. Annual tuition at that time was \$2,200 (in constant dollars). If the state resumes financing a greater proportion of the cost of community college education, then tuition could be lowered and Pay It Forward revenue would cover more students more quickly, rapidly increasing both access and affordability in Washington’s higher education system.

**PAY IT FORWARD AT GREEN RIVER COMMUNITY COLLEGE: GROWTH IN NUMBER OF STUDENTS**



Source: Based on LEAP Budget Office data, 2012.<sup>15</sup>

**Medical School and the Health Professions**

The cost of medical school is a significant driver of medical inflation. The median debt for public medical school graduates exceeded \$119,000 in 2006 – and that debt load has only increased in the past six years. The median debt load for medical school graduates at the University of Washington in 2009, not including undergraduate debt, was more than \$132,000.

The cost of medical school education also creates systemic barriers for students considering medical school. For graduating medical students, climbing debt justifies increasing doctors’ salaries to enable loan repayment. This increase in doctors’ salaries is further aggravated by a limited supply of doctors, a consequence of the initial cost of medical school closing off this career to many aspiring students.

Pay It Forward offers a solution by making it possible for students to pursue a medical degree without paying costs upfront, and provide the same opportunity to future generations of medical students by entirely covering the cost of that education.

For example, assuming the total cost of medical education is \$240,000 over four years (at the University of Washington) and a starting salary after residency of \$160,000 for a family practice doctor, a 5% Pay It Forward contribution each year would generate approximately \$275,000 in 25 years.

This policy could be piloted at the University of Washington Medical School. It might also be feasible to implement Pay It Forward in other professions related to health care, from certified medical assistants to registered nurses to physician assistants.

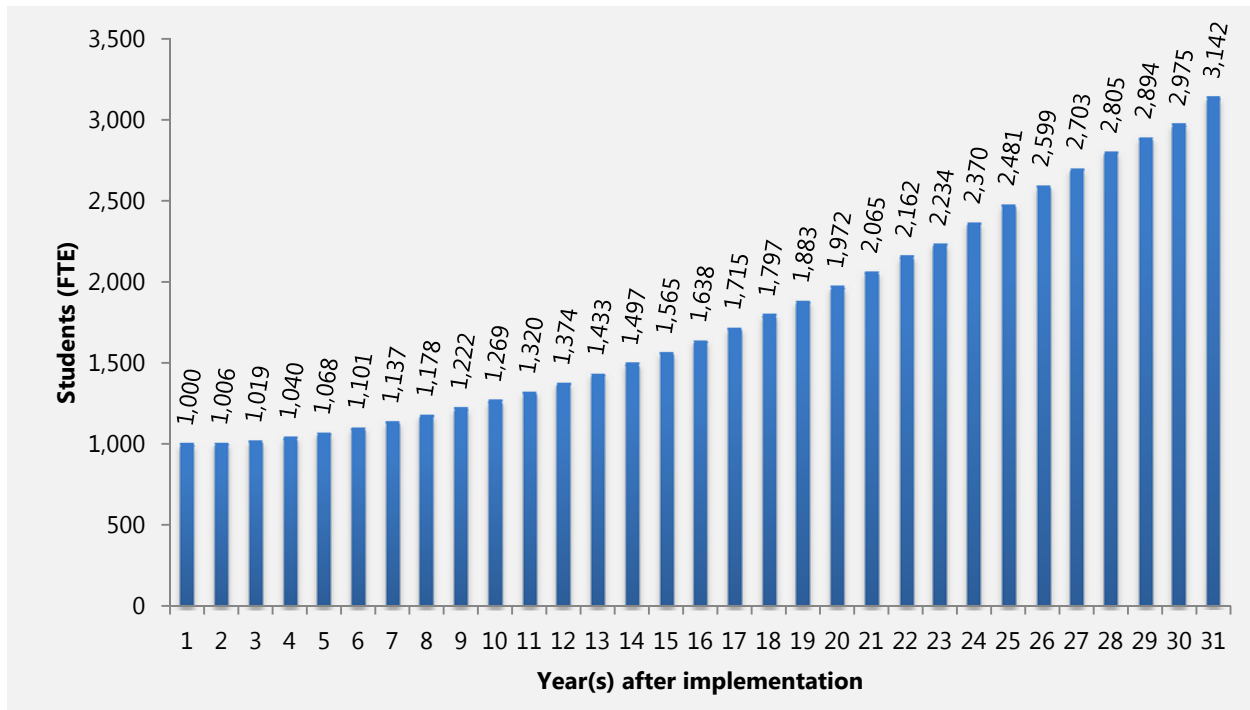


## STEM Education

The Washington Roundtable and Partnership for Learning emphasizes the need for college graduates specializing in science, technology, engineering, and math (STEM). However, reduced public funding has limited the number of students who graduate in these areas. The private corporations that benefit from public funding for STEM graduates could use the Pay It Forward model to strengthen Washington's workforce.

For example, an investment of \$12 million per year would enable 1,000 new students in STEM programs at the University of Washington. Pay It Forward will dramatically enhance the effect of this baseline funding. Within 20 years, an annual \$12 million Pay It Forward investment will enable 2,000 students to participate in STEM programs. Within 31 years, it will enable 3,000 students to participate.

**PAY IT FORWARD STEM EDUCATION: GROWTH IN NUMBER OF STUDENTS**



## Benefits of Paying It Forward

Students make a series of financial decisions regarding college, including which schools they'll apply to and attend, whether to continue their studies each year, and what jobs to apply for after graduation<sup>16</sup>. Each decision has an opportunity and a price, and often students react to these prices in ways that diminish their opportunity.

Pay It Forward equitably funds higher education by tying contributions to a student's ability to pay, ensuring all students pay the same reasonable and sensible percentage of their income. In so doing, it makes college affordable for all qualifying students. It abolishes the financial and psychological barriers to higher education. It catalyzes an educated workforce for the global economy in the 21<sup>st</sup> century. It greatly increases post-graduation career options. It reinforces and returns the public good of higher education to participating students and the public at large.

## Application and Attendance

A number of studies show students are sometimes deterred from applying to college because of “sticker shock”.<sup>17</sup> When students learn about yearly tuition fees and the total cost of attending college, they may decide not even to apply for college or financial aid. The “high tuition - high aid” model used in many states has failed to improve access for many students largely for this reason.<sup>18</sup>

Recent efforts to improve accessibility, such as the US Department of Education’s “College Affordability and Transparency Center,” emphasize that the net cost of college (i.e. tuition fees minus estimated financial aid) is much lower than the sticker price. These efforts are based on studies that have demonstrated that a lack of financial literacy is one reason some students do not apply for financial aid.<sup>19</sup> This may be true – but there are still problems with this approach.

First, even if improved financial literacy promotes college accessibility for some students, it does not actually improve affordability. The majority of students will still have to take on debt to finance their education, which simply defers costs with interest. Loans do not make college more affordable, they only delay and ultimately increase the costs.

Second, financial literacy-based approaches assume all students have the same willingness to take on debt. Knowing about loans does not effectively encourage all students to attend college. “Debt averse” students may well judge that the risks of the post-graduation job market are not worth indebtedness.<sup>20</sup>

There is no conclusive definition of what contributes to debt aversion. Rather, a wide variety of factors, including income, race and ethnicity, as well as family history, culture and immigration status, influence students’ decisions to take on debt. Under Pay It Forward, students would not be required to take on debt or pay any fixed sum, mitigating the effects of sticker shock and debt aversion. Given students’ reactions to tuition increases and indebtedness, it is very likely that Pay It Forward would more appropriately and adequately address students’ concerns about access and affordability.

## Persistence

Each year, students make the decision to either continue college or to drop out. Financial aid, particularly loans, has an important effect on these persistence decisions. For low-income students, loans have been found to have a significant negative impact on students’ decisions to persist.<sup>21</sup> Another study shows grants also have a negative impact on persistence, although their influence is more positive than that of loans.<sup>22</sup>

The correlation between increasing financial aid and a higher drop-out rate may be due to a variety of factors. Students could be exhibiting price sensitivity after having reached their maximum debt threshold. The negative effect of grants could also be due to the fact that grants cover less and less of students’ needs as costs (tuition fees) rise.<sup>23</sup> For debt-averse students, the decreasing purchasing power of available grant aid has a particularly negative effect. A study of financially needy students who chose not to take out loans showed that they were more likely than their indebted peers to leave college before graduating.<sup>24</sup>

Pay It Forward increases the likelihood that students will persist in college by taking rapidly escalating tuition fees out of the equation, making students’ yearly budgets more predictable. Additionally, students will be able to cover more of their total costs of living without going into debt. Although the availability of federal and private financial aid to cover the cost of living may still fluctuate, tuition fees will no longer be a factor in students’ yearly decisions to continue classes.

## Career Choice

Successive decisions to apply, attend and persist eventually lead to graduation and the process of choosing a career. Depending on a variety of factors in the student’s background, including her family’s income, she will likely have accumulated some student loan debt by this point. That debt will be a primary driver of most major

financial decisions for decades after leaving school, with monthly loan payments compromising other expenses, such as child care, housing, and retirement savings.

Further, these payments may push a graduate into jobs which may pay higher wages but for which the graduate is unsuited and the social value for which is undermined and incomplete. Indebted students may be less likely to choose careers that serve the public if the wages aren't adequate for paying off their debt. Careers such as social worker and public defender require postsecondary education, usually have lower wages than jobs in other fields, and carry a hefty price tag.

Recent data from the University of Washington's graduating classes over the past five years show that low-income students who borrow consistently graduate with the highest levels of debt. One study of student debt several years after graduation showed debt burdens remain greatest for borrowers from low- and lower middle-income families. Race and ethnicity also play a large role in debt. After controlling for family income and post-graduation salaries, Black and Hispanic students had disproportionately high debt levels.<sup>25</sup>

Pay It Forward gives students a range of options that high monthly debt service payments greatly limit, including: starting a business, choosing lower-wage public service work, taking family leave, or even going back to school for additional education.

### Pay It Forward versus Loan-based Financing

Pay It Forward compares favorably to average loan payments for students at four-year colleges and community and technical colleges. The total amount a median-income graduate contributes to Pay It Forward is about even or less than the total amount the student would pay in loans. In addition, the monthly share of students' income contributed to Pay It Forward is also less than in loan repayment.

For example, a bachelors degree holder with about \$30,000 in student loan debt would spend over 10% of her annual income on loan payments, compared to only 4% under Pay It Forward. Even if the graduate chooses to pay only 8% of her income with Income-Based Loan Repayment, she could end up paying \$7,000 more than under Pay It Forward.

Pay It Forward also has significant benefits for associates degree holders,. A community and technical college graduate with about \$11,000 in student loan debt would pay more in total under any student loan repayment plan than under Pay It Forward. Additionally, loan payments would make up a larger portion of the graduate's annual income than Pay It Forward (about 4.5% and 1.5% respectively).

#### PAY IT FORWARD VS. LOAN PAYMENTS: BACHELORS DEGREE\*

Years (post-graduation)	Median Adjusted Gross Income (AGI)		Standard Loan Repayment (Monthly)		Income-based Repayment (Monthly)		Pay It Forward Contribution (Monthly)	
	Annual	Monthly	Dollars	% of income	Dollars	% of income	Dollars	% of income
<b>1</b>	\$36,000.00	\$3,000.00	\$348.00	11.6%	\$240.56	8.0%	\$120.00	4.0%
<b>5</b>	\$40,000.00	\$3,333.33	\$348.00	10.4%	\$290.71	8.7%	\$133.33	4.0%
<b>15</b>	\$50,000.00	\$4,166.67	-	-	-	-	\$166.67	4.0%
<b>20</b>	\$52,500.00	\$4,375.00	-	-	-	-	\$175.00	4.0%
<b>25</b>	\$55,000.00	\$4,583.33	-	-	-	-	\$183.33	4.0%
<b>Total Paid</b>			<b>\$46,080.01</b>		<b>\$53,903.79</b>		<b>\$46,900.00</b>	

\*Based on \$33,368 average total debt, 6.8% loan interest, and 4% monthly AGI Pay It Forward contribution.

## PAY IT FORWARD VS. LOAN PAYMENTS: ASSOCIATE DEGREE\*

Years (post-graduation)	Median Adjusted Gross Income (AGI)		Standard Loan Repayment (Monthly)		Income-based Repayment (Monthly)		Pay It Forward Contribution (Monthly)	
	Annual	Monthly	Dollars	% of income	Dollars	% of income	Dollars	% of income
<b>1</b>	\$33,000.00	\$2,750.00	\$127.23	4.6%	\$127.23	4.6%	\$ 41.25	1.5%
<b>5</b>	\$35,000.00	\$2,916.67	\$127.23	4.4%	\$127.23	4.4%	\$ 43.75	1.5%
<b>15</b>	\$40,000.00	\$3,333.33	-	-	-	-	\$ 50.00	1.5%
<b>20</b>	\$42,500.00	\$3,541.67	-	-	-	-	\$ 53.13	1.5%
<b>25</b>	\$45,000.00	\$3,750.00	-	-	-	-	\$ 56.25	1.5%
<b>Total Paid</b>			<b>\$15,268.08</b>		<b>\$15,267.94</b>		<b>\$ 14,625.00</b>	

*\*Based on \$11,056 average total debt, 6.8% loan interest, and 1.5% monthly AGI Pay It Forward contribution.*

## Related Notes

### State Aid

Students have access to many different sources of financial aid to help pay for higher education. In addition to federal and private financial aid programs, students may also receive grants, scholarships and loans from Washington. Out of the state's two-year \$3.2 billion higher education budget for 2009-2011, 15.6% was allocated to financial aid (or \$500 million).<sup>26</sup> In 2011-2013, the state allocated \$2.8 billion to higher education, about 22% of which went to financial aid (or \$607 million).<sup>27</sup>

However, since the state legislature has progressively de-funded higher education overall, funding for financial aid programs hasn't kept up with need. In fact, due to budget cuts, several financial aid programs have been significantly curtailed or even eliminated. As tuition fees have skyrocketed, demand for state financial aid programs like the State Need Grant has increased – as has the number of students eligible for, but not receiving, financial aid. (Please see Appendix C for a more complete review of state financial aid.)

### Federal Aid

The federal government plays a crucial role in helping families and students fund their portion of higher education expenses. Federal aid comprised up to 70% of the total need-based aid disbursed to Washington students in 2010-2011.<sup>28</sup> Recent improvements in federal policy (such as refundable tax credits and loan forgiveness) are a step in the right direction, but do not sufficiently address upfront cost barriers.

The three primary federal funding sources for college students and their families are grants, loans and tax credits. Both loans and grants can be used to cover any education-related expenses, including tuition, fees, books, supplies, transportation, room, board and other costs of living while in school.<sup>29</sup> A new income-based repayment plan for federal student loans caps yearly repayment for principal and interest at 15% of the borrower's discretionary income and in some cases, forgives the borrower's remaining debt after ten years of public service work.<sup>30</sup>

Adopting Pay It Forward would eliminate up-front tuition and fees for students, leaving federal financial aid opportunities available to help students cover other costs associated with attending school. (Please see Appendix D for a more complete review of federal financial aid.)

## International Models for Income-Based Repayment

Australia and the United Kingdom both developed income-based tuition payment programs in response to concerns about the cost of and access to higher education.<sup>31</sup> Both governments experienced growing demand for higher education, while funding was constrained by the actions of these same governments which defunded public services.

Australia's income-contingent loan system allows students to take out loans from the government to cover the cost of tuition, which they then repay after leaving school. Australian students pay different tuition rates based on the program in which they are enrolled, and the repayment amounts also vary. Depending on the graduate's income, she will pay between 4% and 8% of adjusted gross income (AGI) until the debt is repaid. In the UK, government loans may be used to cover tuition as well as living expenses, and all graduates pay a flat rate of 9% AGI.

Both programs have a minimum threshold for repayment. If graduates experience periods of unemployment, illness or are forced to take unpaid family leave, they are not required to make payments as they would under most U.S. federal loan repayment programs. Additionally, borrowers do not need to worry about adverse effects on their credit ratings due to default because payments are adjusted to borrowers' ability to pay.

Although the UK system charges interest above inflation on student loans, the Australian system does not. Payments tied to income ensure that lower-income earners are not penalized for their economic status or for working in lower-wage public service jobs, such as teaching or social work. Both systems are also funded in part by public support, as students' loan payments do not cover the total costs of higher education. (Please see Appendix E and F for more information about income-based repayment systems in Australia and the UK, respectively.)

## Additional Research Required

Given the unique nature of this model, further research is needed to determine the best method for implementing Pay It Forward and for assessing its effectiveness. Additional work with state and federal policymakers will also be required to determine what legal changes may be required to implement Pay It Forward, including necessary changes to financial aid programs.

At the state level, community colleges and four-year schools will be required to coordinate and cooperate in order to determine the percentage of AGI paid by students who attend both types of college, and use a mechanism for redistributing student contributions among those schools accordingly.

In those cases, a nuanced contribution equation must be used. For example, a student earning an associate degree and then going on to earn a bachelor's degree in two years would contribute 3.5% in the Pay It Forward program (1.5% for community college and 2% for university). The payments can be made even more discrete by year or quarter, such that if a student earns a one-year community college certificate (three full-time quarters), her contribution rate would be 0.75% of her adjusted gross income.

Legislation mandating a minimum threshold of public funding will be necessary to ensure the full cost of higher education is covered, both in the short- and long-term.

Changes to federal regulations will also be necessary to implement Pay It Forward. Washington state will likely need to partner with the IRS to monitor and manage graduates' contributions. In addition, a new system for determining students' need through the federal financial aid process will have to be devised, as tuition fees will no longer be part of the equation. (It may also be possible for Pay It Forward to act as a placeholder for tuition in determining federal student aid.)

Qualitative studies are needed to understand how students and their families (including those who are traditionally debt-averse) would view Pay It Forward. Although we anticipate debt aversion will decrease under Pay It Forward, to our knowledge no studies have been done to discover how students would perceive this funding system.

After implementation, further research will be required to determine whether students' choices regarding persistence, majors and careers have changed because of Pay It Forward.

And of course, student organizations, higher education leaders, higher education faculty and staff, and policymakers at many levels need to vet this proposal and understand and agree to implement of one or more versions of it.

# Appendices

## Appendix A: Method and Assumptions

Below are further details on the University of Washington and Green River Pay It Forward models, including cost estimates, wage scales and mortality rates.

### University of Washington and Green River Community College: Pay It Forward Models

Pay It Forward contributions at UW would be a simple 1% of adjusted gross income (AGI) per year of university education (i.e., 4% for four years) continuing for 25 years. Pay It Forward contributions at Green River would be a simple 0.75% of adjusted gross income (AGI) per year of college education (i.e., 1.5% for two years) continuing for 25 years.

#### Notes and assumptions:

- The cost of tuition and fees at UW is \$11,000 in constant dollars, with the state contributing a little less than one-third of total educational costs. If the state assumes a greater proportion, as was the case just five years ago, then the Pay It Forward revenue stream would cover more students more quickly. If the state contributes nothing to educational costs, then the PIF contributions must be extended to at least 30 years and the percent of AGI may have to be increased to 5% for four years of college.
- The cost of tuition and fees at Green River Community College is \$3,500 in constant dollars, with the state contributing slightly more than half of total educational costs.
- All of these assumptions can be modified, with consequent modifications in time frame and percent of AGI.
- Graduates' compensation is calculated from Census Bureau estimates, in constant dollars. This is the median income. Average income will be higher, and so the contribution estimates are conservative.
- Mortality is calculated from DCD Wonder online data base, for Washington state, 2009.
- Productivity increases and linked increases in compensation are not considered. If this consideration was included in these calculations, then the resulting income stream would enable more students to more quickly participate in Pay It Forward.
- The enforcement mechanism must include an agreement with the IRS, to follow graduates when they move to other states and countries.
- Graduates may be able to claim a tax credit for this payback of income, much like student loan interest deduction and certain tuition and fees are subtracted when calculating AGI (lines 33 and 34 of IRS 1040 form). Or graduates may reduce their taxable income by accounting for PIF payments as a form of income tax.
- Calculation of AGI must take into account filing status and the participation or lack of participation of both partners in Pay It Forward.
- If 10,000 students at UW (instead of 8,500) were covered under Pay It Forward in Year 1, then the timeframe to cover 26,000 students is shortened by approximately eight years, shrinking that time horizon to 23 years from the initiation of the program.

## Appendix B: Pay It Forward and Other States

Economic Opportunity Institute researchers have spoken with groups in several other states who are interested in implementing similar policies. Over the coming months, we'll be continuing to share best practices and collaborate with these groups.

The most well-known of these groups is Fix UC. In 2010, California and Washington faced the largest cuts in state funding per full-time student nationwide.<sup>32</sup> Fix UC, a student group in California, recently proposed a model similar to Pay It Forward for the University of California system. For more information about Fix UC, see their website: [www.fixuc.org](http://www.fixuc.org).

## Appendix C: Washington State Financial Aid

### Opportunity Pathways

In 2009, the Washington State Legislature renamed the state's student financial aid programs "Opportunity Pathways." The financial aid programs that make up Opportunity Pathways are overseen by the Higher Education Coordinating Board (HECB), now the Washington Student Achievement Council (WSAC).<sup>33</sup> These programs include:

- State Need Grant;
- State Work Study;
- College Bound Scholarship;
- Opportunity Scholarship Program;
- American Indian Endowed Scholarship;
- Passport for Foster Youth Promise Program;
- Washington Scholars;
- Washington Award for Vocational Excellence (WAVE); and
- Western Interstate Commission for Higher Education (WICHE) Student Exchange Programs.

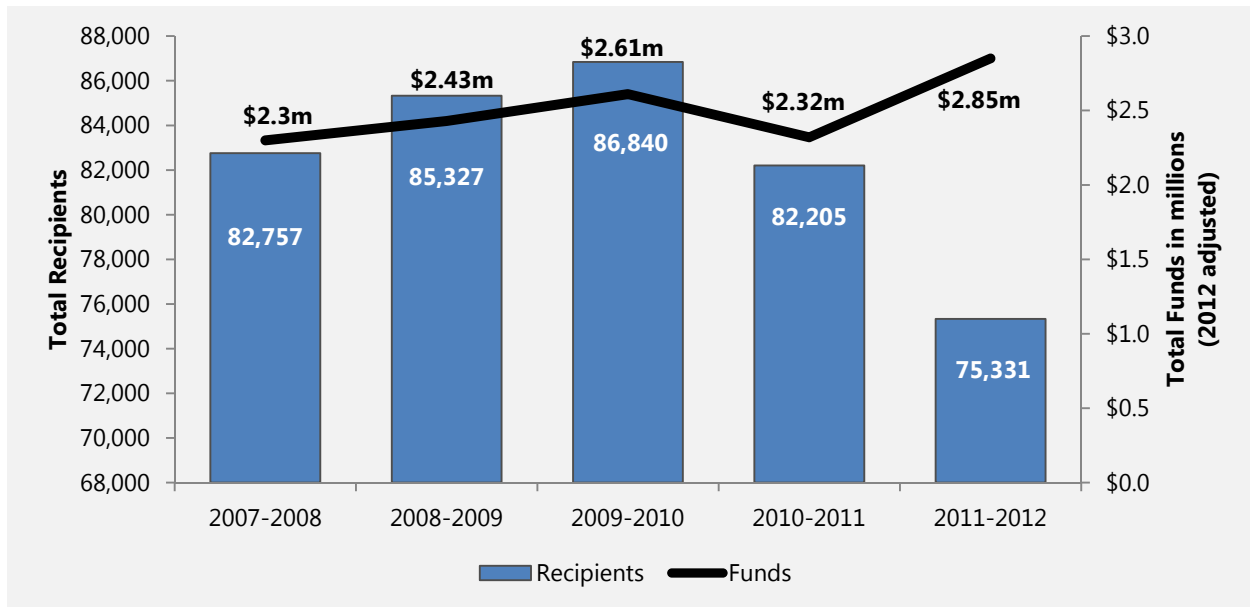
In 2011-2012, Washington state spent \$285 million on financial aid. Financial aid was awarded to 75,331 students that year.<sup>34</sup> While the total amount of aid awarded by the state has increased 9% since 2009-2010 the number of students who receive financial aid from the state has decreased by over 13%. Fewer students are receiving financial aid despite funding increases because most types of financial aid are tied to tuition. As tuition increases faster than financial aid budgets, fewer students are served.



**OPPORTUNITY PATHWAYS FUNDING AND RECIPIENTS, 2007-2012**

Program	2007-2008		2008-2009		2009-2010		2010-2011		2011-2012	
	Funds (millions)	Recipients	Funds (millions)	Recipients	Funds (millions)	Recipients	Funds (millions)	Recipients	Funds (millions)	Recipients
<b>State Need Grant</b>	\$193.8	70,085	\$204.8	72,511	\$222	73,900	\$204.0	72,000	\$267.0	70,000
<b>State Work Study</b>	\$22.0	9,438	\$21.9	9,330	\$22.4	9,400	\$14.3	7,557	\$7.8	3,500
<b>Educational Opportunity Grant</b>	\$3.1	1,361	\$2.9	1,196	\$3.03	1,158	\$0.94	457	n/a	n/a
<b>Passport to College Program for Foster Youth</b>	n/a	n/a	\$0.56	157	\$1.04	240	\$1.2	381	\$1.4	432
<b>Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) Scholarships</b>	\$1.38	464	\$1.2	463	\$1.25	460	\$0.74	261	\$0.42	150
<b>American Indian Endowed Scholarship</b>	\$0.018	17	\$0.017	16	\$0.021	15	\$0.008	12	\$0.014	14
<b>Washington Scholars</b>	\$2.5	412	\$2.7	404	\$2.9	420	\$2.8	377	\$2.3	268
<b>Washington Award for Vocational Excellence</b>	\$1.0	275	\$1.150	302	\$1.36	301	\$0.95	205	\$1.0	188
<b>Alternative Routes to Teaching</b>	\$1.27	292	\$3.0	231	\$2,800,000	249	\$1.75	531	\$1.5	450
<b>Future Teachers Conditional Scholarship</b>	\$0.97	171	\$2.3	454	\$2.3	454	\$0.38	73	\$0.04	8
<b>Get Ready for Math and Science</b>	n/a	n/a	\$1.1	189	\$1.1	189	\$0.70	98	\$0.97	99
<b>Health Professional Loan Repayment &amp; Scholarship Programs</b>	\$3.1	213	\$0.3	46	\$0.34	42	\$4.3	244	\$3.0	218
<b>WICHE Professional Student Exchange</b>	\$0.236	14	\$0.22	13	\$0.21	12	\$0.16	9	\$0.071	4
<b>Washington Center Scholarship</b>	\$0.064	15	\$0.063	15	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total (\$ millions)</b>	\$229.54	82,757	\$242.40	85,327	\$260.98	86,840	\$232.23	82,205	\$285.51	75,331

### FINANCIAL AID RECIPIENTS AND TOTAL FUNDS SINCE 2007



Source: Higher Education Coordinating Board Annual Financial Aid Reports, 2009, 2010 and 2012<sup>35</sup>

### State Need Grant (SNG)

Washington’s State Need Grant (SNG) makes up the largest portion of financial aid offered by the state. The SNG offers need-based awards to Washington residents enrolled in bachelor or associate degree programs. In 2011-2012, the state legislature appropriated \$266 million to SNG, which served 70,000 students.<sup>36</sup>

Students’ families must fall below 70% of median family income (i.e. below \$57,000) to qualify for SNG.<sup>37</sup> The average family income for dependent students (who are supported by their parents) is \$29,000.<sup>38</sup> 62% of SNG recipients are not supported by their parents and have an average income of \$15,000. Over three-fifths of SNG recipients (62%) attend community and technical colleges. 60% are women. About 34% of SNG recipients are students of color.<sup>39</sup>

The amount of money that students receive depends on their family’s income compared to median family income (MFI) as well as their family size. Awards also vary based on full- or part-time enrollment status and school. State Need Grant award amounts are tied to tuition fee increases at public colleges and universities,<sup>40</sup> although award amounts are currently less than the full cost of tuition and fees.<sup>41</sup> Students are required to cover at least 25% of their total cost of attending college (including tuition, fees and living expenses) through other funding sources.<sup>42</sup>

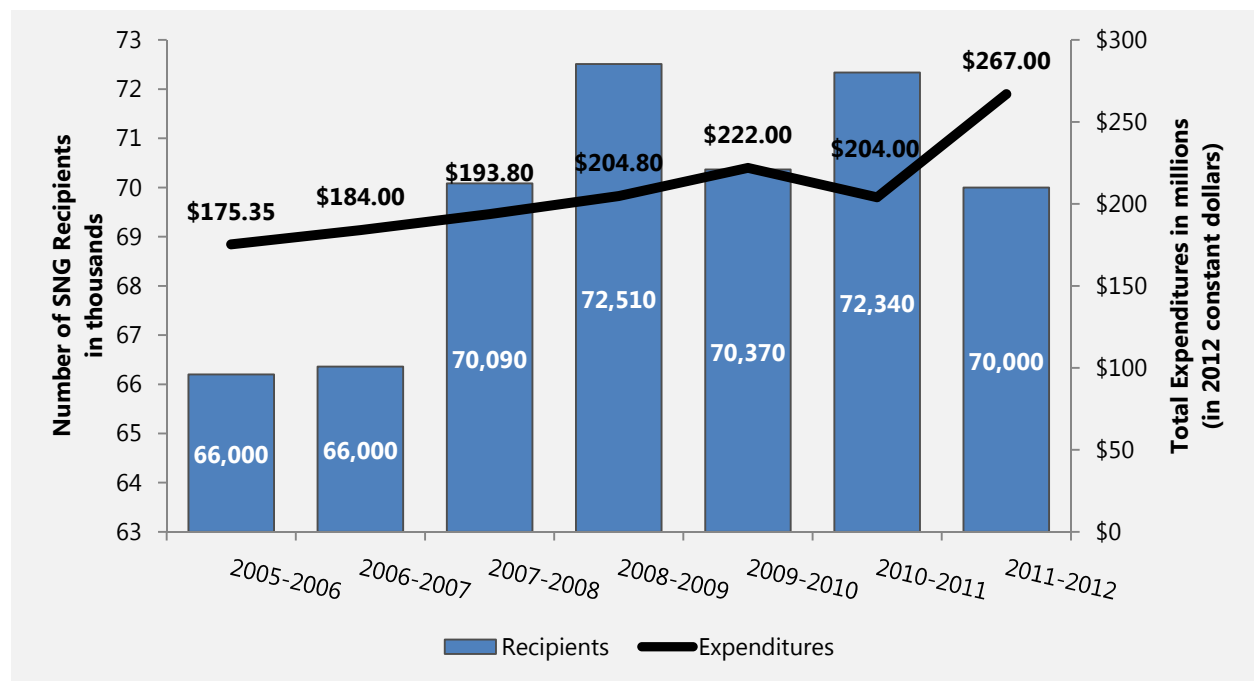
## 2012 MAXIMUM STATE NEED GRANT AWARD VARIATION BY FAMILY INCOME AND SCHOOL

School	2011-2012 Tuition	0-50% MFI (about \$41,000)	51-55% MFI (about \$45,000)	56-60% MFI (about 49,000)	61-65% MFI (about \$53,000)	66-70% MFI (about \$57,500)
University of Washington	\$10,223	\$10,868	\$7,608	\$7,064	\$6,521	\$5,434
Washington State University	\$9,886	\$10,868	\$7,608	\$7,064	\$6,521	\$5,434
Western Washington University	\$12,647	\$7,882	\$5,517	\$5,123	\$4,729	\$3,941
Central Washington University	\$9,832	\$7,631	\$5,342	\$4,960	\$4,579	\$3,816
Eastern Washington University	\$9,640	\$7,196	\$5,037	\$4,677	\$4,318	\$3,598
Public Comm. and Tech Colleges	\$3,542	\$3,696	\$2,587	\$2,402	\$2,218	\$1,848

*\*MFI calculated for a family of four. Source: Higher Education Coordinating Board, 2012<sup>43</sup>*

Overall SNG funds have increased over the last few years. Since 2007-2008, funding for the program has increased 38%. However, the total number of students who receive the SNG fell sharply last year, from 72,300 students to 70,000.

### STATE NEED GRANT FUNDING LEVELS AND RECIPIENTS, 2005-2012



*\*An additional 3,118 grants were funded by institutions due to state budget cuts mid-year. Those grants are not included in this number. Source: HECB Annual Financial Aid Reports 2009, 2010, 2012.<sup>44</sup>*

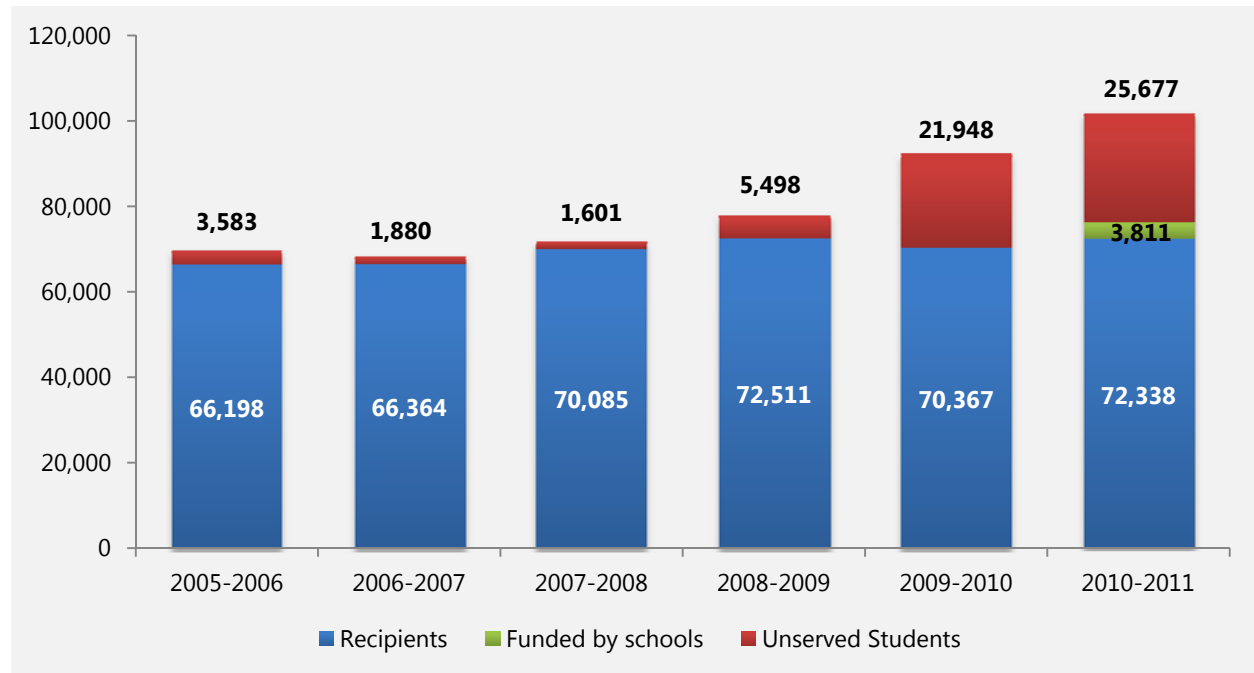
A greater proportion of students are enrolling in community and technical colleges which have lower tuition fees, meaning that award amounts decreased on average.<sup>45</sup> On the other hand, SNG funding has historically been tied to tuition increases and has increased to cover students' rising costs, especially at public research universities.

While SNG recipient enrollment in public research universities has decreased slightly since 2006 (-0.5%), the share of the SNG budget that goes to students in this sector has increased 4.6%.<sup>46</sup> The 2011-2013 biennial state budget increased total SNG funds by \$107 million in an insufficient attempt to address increased costs for low-income students at public research universities.<sup>47</sup>

In recognition of the reality of balancing work and education, the 2011 state legislature did extend SNG eligibility to students who are enrolled less than half-time. This will further expand the number of students who are eligible to receive SNG at lower costs.<sup>48</sup>

The number of students who qualify for SNG has increased sharply over the past five years. However, the legislature has not fully funded SNG. As a result, total funding has not kept pace with demand. In 2010-2011, there were 25,677 students who qualified for the SNG but did not receive it, seven times the number of unserved students in 2005-2006.<sup>49</sup>

### STATE NEED GRANT RECIPIENTS AND UNSERVED STUDENTS, 2005-2011



Source: Washington Student Achievement Council State Financial Aid Annual Report 2012<sup>50</sup>

Unserved students who qualify for the SNG generally attend fewer terms in school and take on more debt to go to school, on average \$2,500 more per year than SNG recipients.<sup>51</sup> 75% of unserved students attend community and technical colleges, 18% attend public four-year schools and 4% attend private four-year schools.<sup>52</sup>

In 2010-2011, the state legislature reduced funding for the State Need Grant by \$25,385,000 in the middle of the academic year. The legislature asked colleges and universities to make up the difference from their institutional budgets, so that students would not lose their grants. 3,811 students received these school-funded grants in 2010-2011.<sup>53</sup>

## State Work Study (SWS)

Washington's State Work Study program (SWS) is the second-oldest state-run program in the country.<sup>54</sup> The goals of the program are to improve student retention, persistence, completion, quality of career choices, and academic engagement.<sup>55</sup> SWS provides work placements for Washington residents who demonstrate financial need and are enrolled in undergraduate and graduate degrees. In 2011-12, the state appropriated \$7.8 million to SWS. The program served an estimated 3,500 students.<sup>56</sup>

The wages for students in SWS jobs are paid in part by employers. In 2011, 40% of the total wages paid to SWS students came from employers.<sup>57</sup>

### AVERAGE STATE WORK STUDY WAGES BY SCHOOL TYPE, 2012

Sector	Amount Earned	Students	Average Wages
Public Four-Year	\$6,811,545	2,712	\$2,511
Private Four-Year	\$5,887,926	1,968	\$2,911
Community and Technical Colleges	\$7,884,777	2,874	\$2,743
<b>Total*</b>	<b>\$20,584,248</b>	<b>7,546</b>	<b>\$2,727</b>

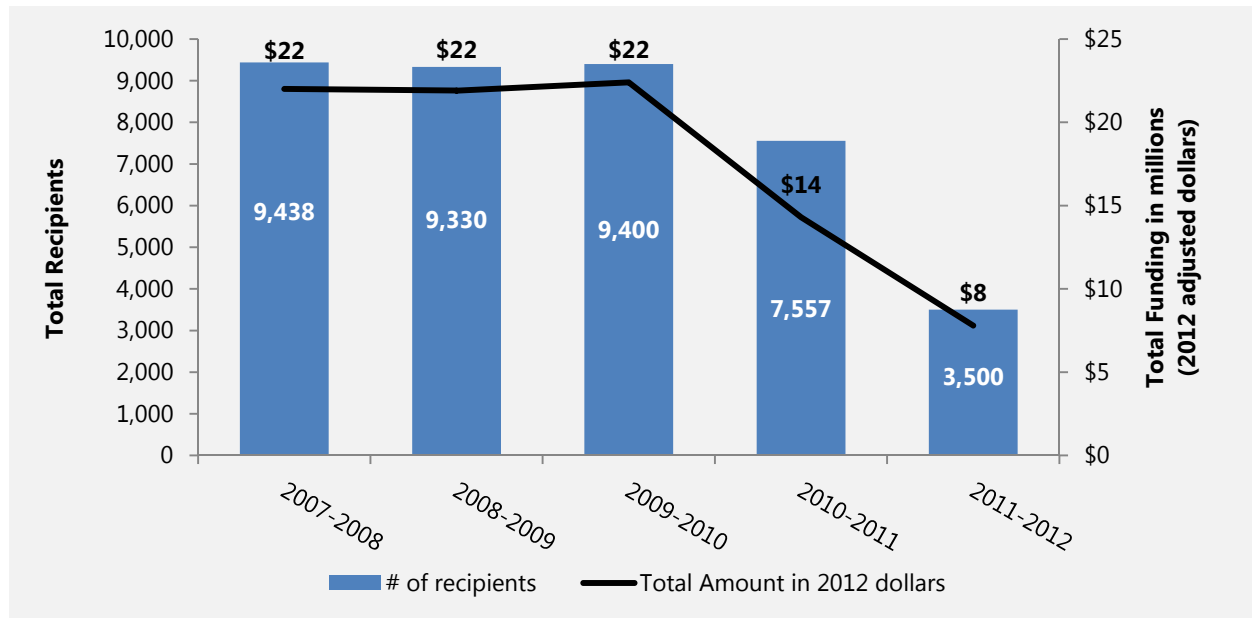
*\*Total count removes duplicate counting of transfer students. Source: HECB Annual Report on State Student Financial Aid Programs, 2012.<sup>58</sup>*

State Work Study (SWS) is available on 55 university and college campuses.<sup>59</sup> SWS provides need-based aid to both undergraduate and graduate students. It is the only source of need-based aid currently available to graduate students.<sup>60</sup> SWS students are generally enrolled full-time. More than half of SWS students are independent (i.e. they do not receive financial assistance from their parents) and have an average income of \$11,600. 38% of SWS students are older than 24, and 21% have children.<sup>61</sup>

The wages earned by SWS students vary by job. There is also a significant difference in job placement by sector. Off-campus jobs generally have higher wages. In 2010-2011, 82% of SWS students in private four-year schools worked off-campus.<sup>62</sup> On-campus jobs generally have lower wages. In 2010-2011, 85% of SWS students in public four-year schools and 84% of students in community and technical colleges had on-campus jobs.

Funding for SWS was drastically cut in the 2011-2013 biennial budget. The state legislature reduced the SWS budget by 66%, or about \$30 million, over the next two years. The budget allocated \$15.67 million to SWS for 2011-2013, far short of the \$45.54 million needed to maintain its current funding levels. SWS eliminated awards to nonresident students and will no longer offer full-time positions during school breaks. Matching rates for employers also increased significantly. The budget cuts will decrease the number of students served by about 13,500 over two years.<sup>63</sup>

## ANNUAL STATE WORK STUDY FUNDING LEVELS AND RECIPIENTS SINCE 2007 (2012 DOLLARS)



Source: HECB Annual Financial Aid Reports 2009, 2010, 2012<sup>64</sup>

### College Bound Scholarship

The College Bound Scholarship is a college access program designed to increase college enrollment for low-income students. In seventh or eighth grade, these students sign a pledge that they will go to college. The pledge also states that the student will graduate high school with a 2.0 GPA, not commit a felony and fill out a Free Application for Federal Student Aid (FAFSA) in their senior year of high school. If students fulfill these promises, and they still need financial assistance to attend college, the College Bound Scholarship and State Need Grant will cover their tuition and fees (at public institution rates), as well as provide \$500 stipends for books.<sup>65</sup>

The program was established five years ago, and the first cohort of students will be registering for their first year of college this fall. Since it was established, over 95,000 students have applied for the scholarship.<sup>66</sup> Applications have been increasing steadily. In the first cohort of students (those who graduated high school in spring 2012), 57% of all eligible students submitted applications. By the fourth cohort (students who will graduate high school in spring 2015), 75% of students applied.<sup>67</sup>

### COLLEGE BOUND ELIGIBILITY AND ENROLLMENTS

	Expected Graduation Year			
	2012	2013	2014	2015
<b>Eligible Students</b>	28,093	28,600	29,586	30,549
<b>Complete Applications</b>	15,857	15,778	20,411	22,876
<b>Percentage of Eligible</b>	56%	55%	68%	75%

Source: Washington Student Achievement Council, 2012.<sup>68</sup>

In 2007, the state legislature appropriated \$7.4 million to establish the College Bound Scholarship, which was invested in Guaranteed Education Tuition Credits. Since then, the funds have grown to over \$12 million.<sup>69</sup> The Caseload Forecast Council has been tasked with predicting future applications so that funds can cover future cohorts.<sup>70</sup>

## **Other scholarships and grants**

Opportunity Pathways also includes several small scholarship and grant programs for targeted student groups. These programs include the Passport for Foster Youth, the American Indian Endowed Scholarship, and Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) Scholarships. Altogether these programs served 596 students in 2011-2012.

### **Passport for Foster Youth**

The Passport for Foster Youth Scholarship provides funding for tuition and fees as well as cost of living while attending college. The maximum amount of the scholarship is \$3,000 a year for up to five years of undergraduate courses. Students who receive the scholarship also have priority standing in applying for the State Need Grant and State Work Study awards.<sup>71</sup> The Passport for Foster Youth replaced a previous program, the Foster Care Endowment, in 2011. Funds from the Foster Care Endowment were transferred to Passport for Foster Youth in the 2011-2013 biennial budget.<sup>72</sup>

### **American Indian Endowed Scholarship**

The American Indian Endowed Scholarship is awarded to students who show academic merit and have ties to American Indian communities. Students must also demonstrate financial need. About 20 scholarships of \$2,000 each are awarded annually. The scholarships are funded by an endowment begun with funds from the state legislature and matched by tribes and individual donors.<sup>73</sup>

### **GEAR UP Scholarships**

GEAR UP is a six-year federal grant aimed at identifying potential college bound students in middle school. The program focuses on low-income students who would be the first in their families to go to college.<sup>74</sup> GEAR UP provides academic tutoring, mentoring services, college and career planning information, financial aid information, college visits, summer camps at the University of Washington and training for teachers in low-income serving schools. Students enter the program in seventh grade and receive services through high-school graduation.<sup>75</sup>

GEAR UP is a partnership between the Washington Student Achievement Council, the University of Washington, the College Success Foundation, and the Office of the Governor.<sup>76</sup>

### **Funding Suspended in 2011-2013**

Funding was suspended for the following programs in the 2011-2013 biennial state budget: State Educational Opportunity Grant, Washington Scholars, Washington Award for Vocational Excellence, WICHE Professional Student Exchange, Future Teachers Program Conditional Scholarship, Alternative Routes to Teacher Certification, GET Ready for Math and Science Conditional Scholarship and the Health Professional Programs Conditional Scholarship and Loan Repayment.

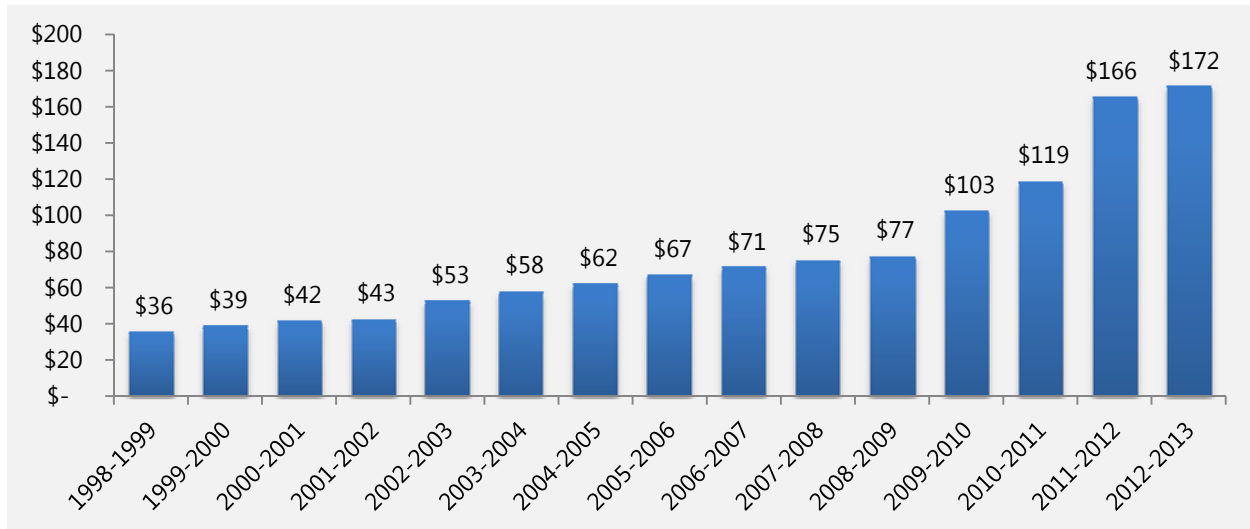
Funding will continue for students who are already receiving awards, but no new students will be eligible.<sup>77</sup> Based on 2010-2011 levels of funding, the total amount cut when these programs were suspended is \$11,980,000. If we assume the same number of recipients as 2010-2011, 1,994 students will not receive funding because of these program suspensions.

## Guaranteed Education Tuition (GET) Plan

Although the Guaranteed Education Tuition Plan (GET) is technically not a financial aid program, it is a popular state-run program that helps many students pay for college. GET was established in 1998 and is one of many state-run pre-paid tuition programs in the US. Last year, there were almost 135,000 GET accounts, the largest number of any such program in the country.<sup>78</sup> GET is administered by the Washington Student Achievement Council (formerly the HECB).

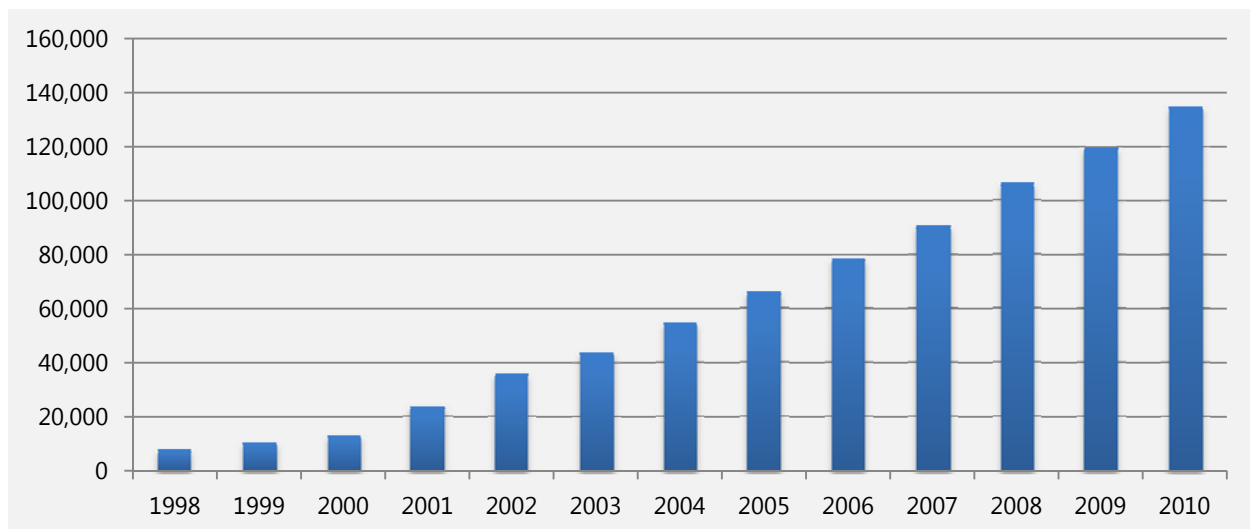
Families purchase GET units that can then be applied to their child's college costs, and the units are guaranteed to cover a specific portion of the cost of college, regardless of tuition or fee increases. The program is designed to help middle income families save for college through guaranteed investments.<sup>79</sup>

**GET UNIT COSTS SINCE 1998**



Source: GET Legislative Report, 2011.<sup>80</sup>

**CUMULATIVE GET ENROLLMENTS, 1998-2010**



Source: GET Annual Report, 2011<sup>81</sup>



One hundred GET units are equivalent to one full year of college tuition (based on the most expensive in-state tuition at a public university in Washington.) Anyone can purchase up to five hundred units, or up to five years worth of tuition. The units can also be applied to costs of living (such as books, transportation or room and board).<sup>82</sup> The units' value is based on costs for Washington public colleges, but they can be used at almost any public or private college in the US and some universities abroad.<sup>83</sup> The current price of a GET unit is \$172.<sup>84</sup>

GET account holders are mostly middle- and upper-income families. Although GET does not require purchasers to report their income, over 60% of those who reported income were from households making \$50,000 a year or more. Less than 1% of GET account holders make below \$20,000 a year.<sup>85</sup>

As GET unit prices increase at a slower rate than tuition fees, GET may not be able to cover future payments. GET currently has an unfunded liability of \$631 million,<sup>86</sup> and the State Legislature is discussing ways to cover its contractual obligations to GET account holders. Last session, legislators considered ending the current GET program and establishing "GET 2" which would have decreased the value of GET credits. While the Legislature has not yet decided GET's fate, dramatic changes are necessary and inevitable.<sup>87</sup> It seems unlikely the program will continue to be a good investment for Washington families.

## Appendix D: Federal Financial Aid

To qualify for federal grants and loans, students and their families must complete the Federal Application for Student Aid (FAFSA). The Department of Education uses this information to determine the student's expected family contribution (EFC) toward the total costs of college attendance. EFC is determined using a federal formula that calculates income, tax allowances and assets for both parents and students.<sup>88</sup> Beginning in July 2012, the maximum annual family income level to automatically qualify for an EFC of \$0.00 will be lowered from \$32,000 to \$23,000, thereby decreasing access to college for future cohorts of low-income students.<sup>89</sup>

### Federal Grants

Pell Grants are the largest form of grant aid for postsecondary education.<sup>90</sup> Pell Grants are need-based. Need is determined by a student's EFC, costs to attend school and enrollment status.<sup>91</sup> The large majority of grant recipients are low-income students. In 2009, an estimated 76% of grant recipients had family incomes at or below \$30,000 a year.<sup>92</sup> The maximum Pell Grant amount was \$5,416 in 2009-2010, although only 28% of recipients received this amount. In order to receive the maximum Pell Grant amount, students must have an EFC of \$0.00. Even if students qualify for the full Pell Grant amount, they may receive less depending on the average cost of attendance at their school. The average Pell Grant per recipient was \$3,751 in 2009-2010.<sup>93</sup>

Although total Pell Grant expenditures have dramatically increased since the program began, so has the demand for the grants. In 2010, expenditures on Pell Grants were 6.17 times greater than in 1977 in constant dollars, and the number of grant recipients was 4.67 times greater.<sup>94</sup> Because of rising tuition and fees, the grants cover less of the costs incurred by students. At the University of Washington, for example, resident students are advised to budget about \$26,000 a year for their tuition, fees, books, room and board, transportation and personal items.<sup>95</sup>

In Washington State, over 80% of Pell Grants go to students at public institutions, and over 12% go to students at private, for-profit colleges. About 7% of Pell Grants go to students at private, not-for-profit colleges.

### WASHINGTON STATE PELL GRANT AWARDS BY TYPE OF INSTITUTION IN 2009-2010

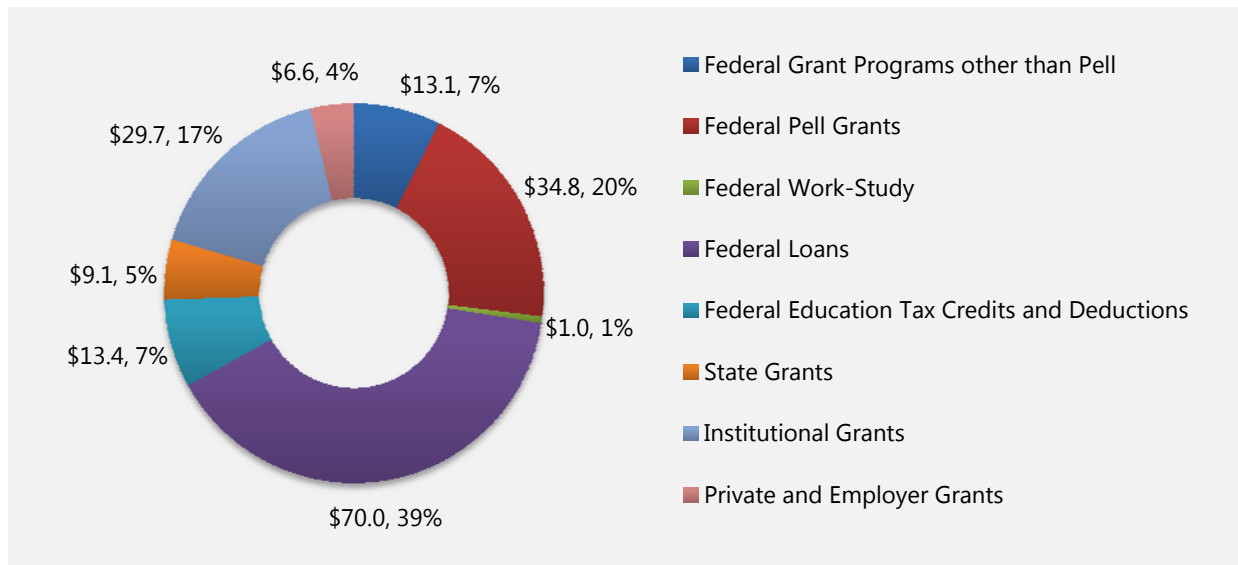
Public		Private (Non-Profit)		Private (For-Profit)		Total	
Recipients	Awards	Recipients	Awards	Recipients	Awards	Recipients	Awards
96,907	\$347,180,940	8,373	\$32,452,215	14,773	\$51,848,934	120,053	431,482,089

Source: 2009-2010 Federal Pell Grant Program End of Year Report <sup>96</sup>

## Federal Loans

Student loans make up the majority of federal financial aid. Until 2010, banks could offer student loans and were guaranteed by the federal government under the Federal Family Education Loan program (FFEL). The Health Care and Education Reconciliation Act of 2010 ended the FFEL loan program, and all loans since then have been disbursed and guaranteed by the federal government under the Direct Loan program. The current interest rate for subsidized direct loans is 3.4%.<sup>97</sup>

### \$177.6 BILLION IN FEDERAL STUDENT AID AWARDED IN 2011



Source: Trends in Student Aid 2011, The College Board.<sup>98</sup>

Students and their parents have a variety of loan options. The type of loan and the student's EFC determines the amount they can borrow. Students are generally eligible for some subsidized loans. The government will pay the interest on these loans while the borrower is enrolled in school and during the six month grace period before repayment begins. For unsubsidized loans, interest accrues from the day the loan is disbursed.

Any student can apply for Direct Loans, regardless of need. 15% of federal loan recipients in Washington are "non-needy", meaning their family income should cover the cost of attendance.<sup>99</sup> However, students in high income brackets generally borrow at high levels. There has also been a steady increase in the average loan amount for low-income students. Washington resident undergraduate students at public four-year colleges with need borrowed \$8,342 on average last year, compared to \$7,052 in 2004-2005. At community colleges, the average loan amount increased from \$3,949 in 2004-2005 to \$5,528 in 2010-2011 for needy students.<sup>100</sup>

### AVERAGE LOAN AMOUNT, WASHINGTON STATE COLLEGE STUDENTS, 2010-2011

Sector	Need-based Aid Recipients with Loans	Average Annual Loans	Non-Need Based Loan Recipients	Average Annual Loan
Four-Year Public	35,650	\$8,342	7,974	\$11,221
Two-Year Public	33,685	\$5,528	3,481	\$4,958
Four-Year Private	10,126	\$10,984	1,376	\$11,112
Private Career	6,260	\$9,072	347	\$9,974
<b>Total</b>	<b>85,130</b>	<b>\$7,654</b>	<b>13,135</b>	<b>\$9,533</b>

Source: Key Facts for 2012, Washington State Student Achievement Council (formerly the Higher Education Coordinating Board)<sup>101</sup>

There are several repayment plans for Direct Loans, some of which require low-income or no income to qualify. Under the “standard repayment” plan, borrowers pay a fixed amount each month towards their capital and accrued interest. Borrowers may also chose the “graduated repayment” plan, where payments gradually get larger. The assumption behind “graduated repayment” is the borrower’s income will grow steadily, making it easier to repay their loans. An explanation of the most commonly used repayment methods is below.

### FEDERAL LOAN REPAYMENT PLANS FOR DIRECT LOANS

Name	Repayment Time Frame	Monthly Payment	Notes	Example: Monthly payment : \$30K debt, 6.8% interest
<b>Standard</b>	Fixed payment for up to 10 years. Up to 30 years for consolidated loans	Fixed. Payments must be at least \$50 per month.	If you do not choose a repayment plan when you first begin repayment, you're automatically enrolled in this one.	\$345.24 for 120 months <sup>102</sup>
<b>Graduated</b>	Up to 10 years. Up to 30 years for consolidated loans.	Payments start out relatively low at first and then increase, usually every two years. They must at least cover the interest that accumulates on the loans between payments.	The plan is tailored to individuals with relatively low current incomes who expect their incomes to increase in the future. Ultimately borrowers will pay more than under the Standard Plan, as more interest accumulates in early years of repayment when the outstanding loan balance is higher.	<u>Initial payment:</u> \$172.62 <u>Final payment:</u> \$342.67 For 20 years <sup>103</sup>
<b>Extended</b>	25 years	Fixed or graduated. Monthly payment is lower than under the Standard plan.	Must have more than \$30,000 in loans. Borrowers will ultimately pay more because of the interest that accumulates during the long repayment period.	\$208.22 for 301 months <sup>104</sup>
<b>Income-Contingent Repayment Plan (ICR)</b>	25 years of repayment, after which the unpaid portion is forgiven	Monthly payment based on annual income, family size and total loan amount.	Borrower must pay income tax on the amount of loan that is forgiven	<u>First payment:</u> \$269.07 <u>Max. payment:</u> \$288.01 <u>Paid over 14.3 years:</u> \$47,333.35 <u>Forgiven:</u> \$0.00 <sup>105</sup>
<b>Income-Based Repayment Plan (IBR)</b>	25 years of repayment, after which the unpaid portion is forgiven. Forgiveness after 10 years available for some public service careers.	Monthly payments capped at 15% of discretionary income (the difference between Adjusted Gross Income and 150% of the poverty guideline for borrower's family size and state of residence.) Must have partial financial hardship to qualify.	Borrower must pay income tax on the amount of loan that is forgiven.	<u>First payment:</u> \$240.56 <u>Max. payment:</u> \$345.24 <u>Paid over 12.5 years:</u> \$45,915.66 <u>Forgiven:</u> \$0.00 <sup>106</sup> (15% version, 10% not yet available.)

Source: U.S. Department of Education, “Your Federal Student Loans” <sup>107</sup>

“Income Based Repayment” (IBR) is a new repayment plan that calculates student’s payments based on income and family size.<sup>108</sup> Annual repayment amounts are currently capped at 15% of their discretionary income (the difference between adjusted gross income and 150% of the federal poverty level), and starting in 2014, this will decrease to 10% of discretionary income.<sup>109</sup> Additionally, loan and interest balances are forgiven after 25 years of repayment. When borrowers are unemployed or their monthly repayment amount is calculated below \$5.00, the monthly repayment amount is \$0.00. These months are still counted towards the 25 year cap. If a borrower’s repayment amount does not cover the interest that accrues that month, the federal government will subsidize the borrower’s remaining interest for up to three years after the borrower begins repayment under the IBR plan.<sup>110</sup>

Public Service Loan Forgiveness is another important feature of the IBR plan. Borrowers who pay under IBR can have their loans forgiven after ten years of working in a qualified public service organization. Qualified organizations include state, federal and local government agencies and organizations, as well as 501(c) (3) non-profit organizations.<sup>111</sup> Not all borrowers are eligible for IBR, and all IBR borrowers still pay interest on their loans after the three years of subsidy are used.

## Federal Education Tax Benefits

The federal government offers several kinds of education tax benefits as another form of financial aid. These include the Lifelong Learning Credit, the Hope Credit, veterans’ benefits, tuition and fees deductions and the American Opportunity Tax Credit (AOTC). Like loans and grants, these tax benefits are intended to “assist with the expense of higher education.”<sup>112</sup> However, education tax benefits have not improved equitable access to college or college affordability for many families.

The AOTC, created by the Obama Administration in 2009, is an expansion of the Hope Tax Credit. Before the AOTC, other tax benefits were not refundable, making it difficult for low-income students to qualify. Even those who did receive the benefits received lower average amounts than middle-income students.<sup>113</sup> The AOTC is partly refundable, meaning that even if families do not owe taxes, they are still able to receive up to \$1,000 to help pay for tuition and fees.<sup>114</sup>

Between 2008 and 2009, the proportion of education tax benefits distributed to families with low adjusted gross income (below \$25,000) increased from 5% to 17%.<sup>115</sup> However, because the AOTC also raised the maximum income level allowed to claim the credits from \$120,000 for joint filers to \$180,000, the proportion of education tax benefits distributed to families with high adjusted gross income (above \$75,000) was 24% in both 2008 and 2009. The proportion of benefits distributed to middle-income families (between \$25,000 and \$74,999) decreased from 51% in 2008 to 38% in 2009.

Some concerns remain about the effectiveness of tax credits. Although some AOTC funds are available to previously ineligible families, they still only receive 40% (\$1,000) of the available \$2,500 credit. In addition, studies have shown that education tax benefits have not been effective in increasing college attendance for students from any income level.<sup>116</sup> Like loan forgiveness programs, education tax benefits, specifically because they are realized as much as a year after the payment of tuition, only ease the burden of college costs after a family has already placed themselves in financial hardship. For some students and families, the upfront costs of college are an insurmountable barrier, meaning that they will never have the chance to benefit from federal aid.

## Appendix E: Australia: The Higher Education Contribution Scheme

In 1989 the conservative governing coalition in Australia implemented the Higher Education Contribution Scheme (HECS), the first national income-contingent loan program. It was unprecedented in its size and its staying power. Under HECS, an Australian student is required to pay tuition fees. The student can choose to pay the fees at the beginning of each school year and receive a 25% discount. Alternatively, the student can take out a loan from the Australian government to cover her fees until after she graduates and earns a

minimum income level. Her loan payments will be deducted from her salary as a set percentage of her taxable income. The student has a third choice: she can also choose to pay some of her fees before school for a 10% discount and pay the remainder after graduation through income-contingent repayment.

Australia experimented with several different funding models for higher education, including upfront tuition fees (before 1974) and free education (from 1974-1985). HECS combined elements of both of these funding models by allowing students the option to pay tuition fees upfront at a 25% discount or defer payment until after graduation, when they would pay fees as a percent of their income. Fee amounts fall into three categories, which are based on the cost of instruction and potential earning power of different courses of study. Repayment rates vary between 4 and 8% of students' annual income based on their income bracket, as determined annually by the Australian Taxation Office.<sup>117</sup>

Australia's university system is funded at the national level, which simplifies the repayment process. The Australian Ministry of Education, Employment and Training works with the Taxation Office to collect borrowers' loan repayments. Given that the collection system was already in place, the cost of implementation was fairly low for the government and for academic institutions. The Taxation Office estimates that it spends only 1% of total HECS revenues per year on administrative overhead.<sup>118</sup>

Politically, HECS was a very popular program. Funding for higher education had been strained even before tuition fees were abolished in 1974. Before 1974, only 25% of students paid full tuition fees, thanks to a generous national scholarship program.<sup>119</sup> Traditionally the government limited enrollment based on the amount of available public subsidies per student. HECS was designed to increase future revenues, so the government raised the enrollment cap in 1989. In 1988, there had been widespread demonstrations against a proposal for a nominal flat tuition fee. When HECS was introduced in 1989, there was no significant resistance to the program.<sup>120</sup>

HECS revenue is projected to grow over the long term, mostly because higher earning students pay more through income-contingent repayment. The government anticipates that if 80% of all current loans are repaid in full, total higher education revenue will grow by 20%.<sup>121</sup> Economic models of future repayments show that some groups of borrowers, such as women, are likely to take longer to repay their loans (than men) because of differences in average wages and trends in family leave.<sup>122</sup> Given that there is zero real interest charged on student loans, the net present value of a student's debt is actually lower if these students pay back over a longer period of time. This means that wealthier graduates pay more through income contingent repayment in terms of net present value.

Enrollment has steadily increased since the implementation of the program, although it is unclear whether this trend is attributable to HECS or to growing demand for university degrees. Before HECS was implemented, between 1960 and 1975 the number of universities in Australia doubled to meet demand.<sup>123</sup> Since the start of HECS in 1989, enrollment has steadily increased each year by an average of 4%.<sup>124</sup>

Despite the steady increase in enrollment, the socio-economic makeup of the student body has not changed substantially. The Australian government is increasing investment in academic and personal support services for low-income students in order to increase the degree completion rate for low-income students from 15% to 20% by 2020. The government also plans to increase the overall degree attainment rate for 25-34 year olds to 40% by 2025.<sup>125</sup> The government has noted that success in secondary school and knowledge of the benefits of higher education has a significant impact on the decisions of low-income students to attend university.

Increases in total enrollment may also be due to a surge in international student enrollment. HECS only funds operational and instructional costs, but does not provide funding for capital improvements or help universities develop specialized programs or services to attract students. This has led many institutions to start fundraising departments and to aggressively recruit students from abroad.<sup>126</sup>

John Howard's conservative governing coalition partially deregulated fees in 1996 and allowed institutions to enroll a certain portion of students who would not receive any public funding and not be eligible for HECS. The stated intent was to provide more revenue to universities. In effect, this reform has increased inequality between students. Encouraging privatized enrollments to increase revenue may also increase the likelihood that wealthy students will be admitted on the basis of ability to pay, rather than academic merit.<sup>127</sup>

## Appendix F: The United Kingdom: Income-Contingent Loans

The United Kingdom has experimented with several methods for funding higher education over the past two decades. The government has tested various combinations of grants, loans and repayment methods. Income-contingent loans have been used in some form since 1990. UK students must pay tuition fees, but they can get an income-contingent loan from the government. Unlike in Australia, there is no discount for paying any portion of the fees before school begins. Students' repayments will begin automatically once they meet a minimum income level after graduation.

The UK centrally determines higher education policy. Until 2006, tuition levels were established nation-wide. Similar to the Australian model, repayment for income-contingent loans is subtracted directly from graduates' salaries once their incomes pass a certain threshold. In 2011-2012, this threshold was set at £21,000 (about \$32,700 US) and the payment rate was set at 9% of annual taxable income.<sup>128</sup> Students are also eligible for loans to cover the cost of living while they are in school. These loans function the same way as loans which cover tuition and are included in the repayment plan. Although the cost of living varies depending on where students reside, tuition is currently capped at £9,000 a year, or about \$14,000 US.

From 1962-1989, undergraduate student tuition was free and the entire cost of education was covered by the government. In 1990, the Conservative government began to charge tuition fees and student loans were introduced for the first time. These loans had a zero real interest rate and did not have to be repaid until after a borrower was earning a certain minimum income level. After the borrower reached that level, the loans had to be repaid within five years. Additionally, grants were frozen at 1989-1990 levels, so that the real value of total available grants decreased with inflation each year.<sup>129</sup>

In 1998, the Teaching and Higher Education Act created different tuition fee levels based on the potential earning power of different courses of study, removed the five year time limit for loan repayment and made loans income-contingent. The Act also lowered the income threshold for beginning repayment and abolished need-based grants.<sup>130</sup> The complexity of administering the new reforms added to the cost of the program and may have reduced access for less financially literate, and often lower-income, students.<sup>131</sup>

A series of changes in government policy from 2004-2006 gave universities the power to set their own tuition fees up to a certain maximum limit. The interest rate on loans remained indexed to inflation, and students can write off any remaining debt after 30 years. The reforms also reintroduced need-based grants and raised the income threshold for repayment, in addition to creating a central Office for Fair Access which consults with universities about increasing access for low-income students.<sup>132</sup>

In 2011, the government announced that need-based grants, which are given directly to students, would be supplemented by the National Scholarship Programme (NSP) as of fall 2012. The NSP funds are disbursed to universities, which can use the funds to lower tuition, housing or other costs for low-income students. A maximum of £3,000 can be spent per student, and only £1,000 of those funds can be given directly to the student in the form of a cash grant.<sup>133</sup>

As of September 2012, the interest rate on student loans was changed. Up until graduation, interest will be indexed to inflation plus an additional 3%. After graduation, loans will be indexed only to inflation, up to a certain minimum income threshold. After meeting that threshold, interest is determined based on the borrower's salary, so that after a borrower earns £41,000, interest returns to 3% plus inflation.<sup>134</sup>

A note of caution: The general trend is in the UK to increase tuition fees and increase loans, with some small corresponding increases in grants and scholarships. Like in Australia, students in the UK have gone from free tuition to increasingly large debts repaid over several decades. An example of this rapid increase in debt can be seen in the portion of a student's income that comes from loans. One study examined fluctuations in students' total income from various sources, including their parents, loans, grants and credit cards, compared to financial aid policy shifts. In 1992, about 7% of students' income came from loans. By 1995, 14% of students' income came from loans, and by 1998 it had risen to 24%. In 2002, student loans represented just over 40% of a student's income, far outpacing other sources, such as parents, work, savings and credit.<sup>135</sup>

Recent trends in college attendance in the UK indicate that these policy changes have not increased access for most students. Although researchers have noted that there is a lack of studies on how debt aversion (or unwillingness to take on debt) contributes to these trends, the larger number of affluent students shows that the correlation between income and college attendance has only gotten stronger as the government increases its reliance on student debt to fund higher education.<sup>136</sup> If the goal is to increase access to higher education, policy changes in Washington state should not replicate this trend.

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