

THE IMPACT OF THE FEDERAL NEEDS ANALYSIS FORMULA ON STUDENT'S WHO WORK FOR PAY

A study of first-time, low-income freshman attending the University of Maryland

A college education is an investment in the future of the individual and in the future of society. It pays dividends in the form of higher lifetime earnings for the student and higher income tax revenues for the government. A college student with an undergraduate degree, for example, will contribute nearly \$100,000 more in federal income tax over the course of a lifetime than someone with only a high school diploma. Financially, education is an economic benefit to the student and to society. Society also benefits from lower crime rates, decreased poverty, and improved health of a more educated population. When totaling all the benefits, investing in higher education yields a positive return on investment, both quantitatively and qualitatively.

Given such economic and social gains, it is no surprise that legislators, researchers, and educators are concerned about the affordability of higher education today. Tuition prices have increased nationwide by an average of 12%, which has outpaced both personal income growth and inflation. The impact of these rises in educational costs is obvious as attendance of low-income families continues to decline. Furthermore, for those low-income students who work, the impact is even greater as eligibility for need-based grants decreases with increased earnings and savings. Congressman Ric Kellar, a Republican from Florida, has taken issue with the needs-analysis formula and has voiced his concerns to the House of Representatives Committee on Education and the Workforce, noting that the needs-analysis formula penalizes students who work, especially for Pell grant recipients, aid which is designated for low-income families. His proposal is to amend the needs analysis formula when

Congress considers reauthorization of the Higher Education Act next year. Congressman Kellar recommends, "...If the student goes the extra mile and works during his college experience, he will not be penalized by having his Pell grant taken away from him."

The purpose of this paper is to examine the effectiveness and viability of the federal needs analysis formula on the student contribution for low-income families and to address the following questions:

1). What impact does the student's contribution, as mandated by the federal formula, have on the types of aid received by low-income students who work for pay?

2). What does research indicate the relationship is between access and affordability, and types of aid received for students who work for pay from low-income families. These questions are pertinent as many families reevaluate the opportunity costs of obtaining an undergraduate degree.

Brief History of Needs Analysis:

Originally, the goal of the Higher Education Act of 1965 was to increase access to higher education for low-income families in the form of gift aid, such as the Federal Pell Grant and State Educational Opportunity Grants. As the cost of education increased, this mandate was expanded to the middle class in the form of loans. However, Pell Grant funding has not kept pace with the rise in tuition. The latest trend has been the rise of student loan programs, which have veered away from a need-based approach to a merit-based approach or student loan programs. Both of these efforts defeat the underlying principal surrounding the needs analysis formula, which is to provide access to higher education.

The need analysis formula relies on benchmark income levels to set several of the allowances against income and assets. The federal formula allows a dependent student to earn up to \$2,380 each year without being penalized for working. This is called the Income Protection Allowance (IPA). The IPA is based on an income level below which a student is assumed to have no discretionary income. For the 2003-2004 academic year, all funds that are earned above \$2,380 are considered available income and are taxed at 50%. For a dependent student, all funds that are saved over time are taxed at 35% each year. Overall, the financial aid system was designed to ensure that the decision of low-income students to attend college would not be constrained by financial need.

Collection of Data:

To determine the impact of the federal formula on low-income students who work for pay and the implications for policy change, data was collected on a representative cohort of students attending the University of Maryland, College Park campus. The population of students chosen for this research study was dependent, first-time freshman attending the Fall 2003 semester. The profile of students was narrowed to include only those students who filed the Free Application for Federal Student Aid (FAFSA), with a parent contribution (PC) of \$3,850 or less, with one family member attending college. The cut off range of \$3,850 for the parent contribution is important because \$3,850 is the maximum expected family contribution allowable for a student to receive a Federal Pell Grant ($SC + PC = EFC$). This means that the parent's income and asset information demonstrated Pell Grant eligibility range, which ultimately illustrates the parent's socioeconomic status and ability to pay for college. Therefore, these families are hit the hardest by price increases demanding a larger percentage of their income to pay for the

cost of education. Knowing this, if a student has a SC equal to zero, the student is eligible for a pell grant based solely on the parent's financial status. However, if a student in this study earned more than the protected income allowance and/or saved any money, then the student contribution coupled with the parent contribution would eliminate the student from receiving a pell grant. Ultimately, students with earned income are required to contribute more toward their education since the needs analysis formula considers a student's available income as discretionary. This is in fact an outdated policy considering that many low-income children who work for pay may be supplementing the family income. Furthermore, most families feel that the expected family contribution assessed does not accurately reflect the families true ability to pay. In addition, because Pell Grants are designated for low-income families, Pell Grant recipients are more likely than non-recipients to qualify for and receive additional types of financial aid such as loans, work-study, and other grant aid, putting a greater burden on low-income students who work above the IPA.

Analysis of the Data:

The initial data collection gathered 1276 first time, low-income freshman whose parents have a parental contribution equal to less than \$3,850. Upon a thorough review of the data, 25 students, or 2% were identified as having made obvious data errors on the FAFSA. These errors ranged from erroneously putting parental data in the student's section to inputting an inflated amount of taxes paid. When verified and corrected, these students were eliminated from the study narrowing the applicant pool to 1251 students.

A quick analysis of the data revealed that 61% of the 1251 students worked during their senior year in high school. According to the National Center for Education

Statistics, 92% of first-time students held a job while they were enrolled. The average earnings for the UM first-time freshmen were \$3,792. Only 364 students did not demonstrate any income or savings during their senior year of high school (See Table 1). Understandably, these students may have chosen to volunteer their time, participate in extra curricular activities, or work without pay such as babysitting siblings. Collectively, at the University of Maryland, of those undergraduates who filed a FAFSA for the 2003-2004 academic year, 85 percent had earned income the previous year. This is consistent with national statistics, which show that about 79% of undergraduates work while enrolled. Furthermore, as Table 2 illustrates, freshmen are more likely to withdraw from classes when working above 15 hours per week. A recent study indicates that low-

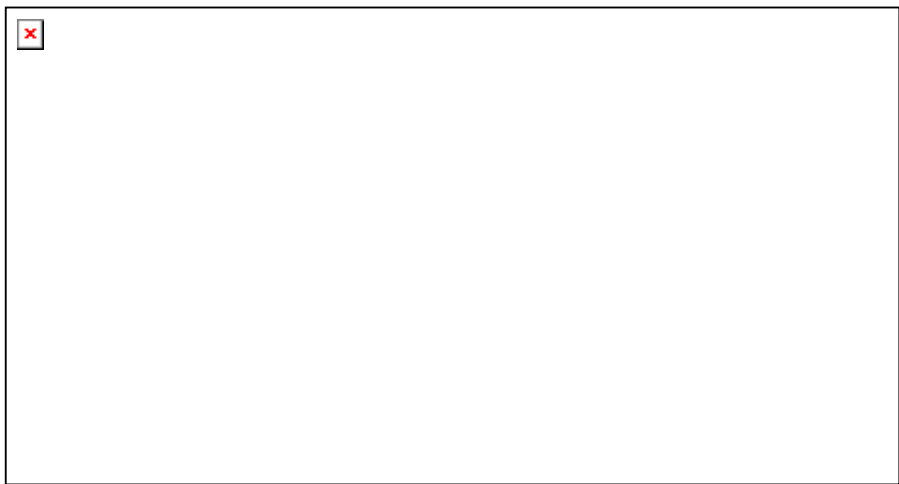
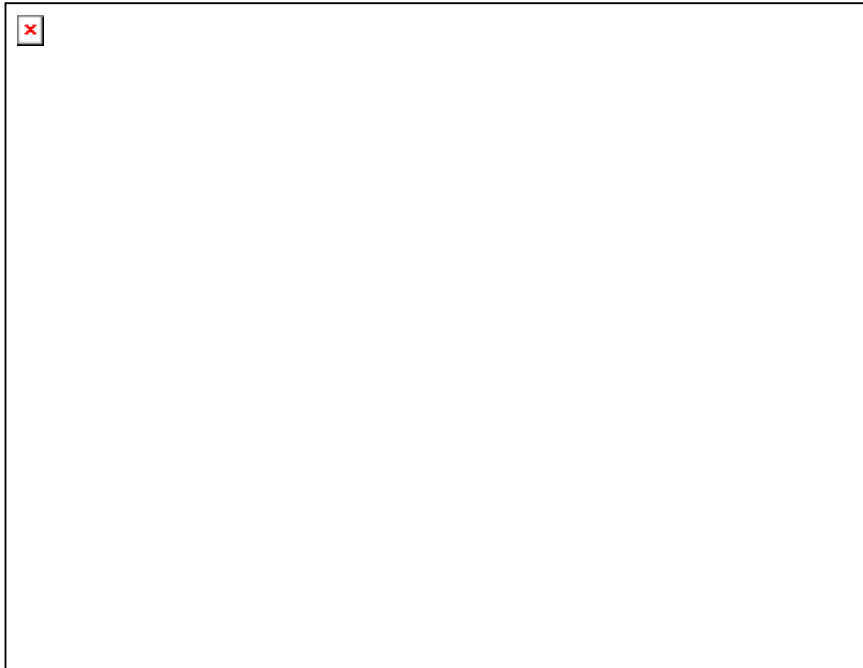


Table 1. This shows that the majority of low-income students, who attend the University of Maryland in the Fall 2003, worked or saved some money during their senior year in high school. Only 27% of students did not work the previous year or save any funds.

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Table 2. Recreated from “Undergraduates Who Work”. Among students who either did not work or who worked to pay education expenses and who had a goal of obtaining an associates or bachelor’s degree, the percentage not enrolled for a full year, by the average hours worked per week while enrolled in school for the 1995-96 academic year.

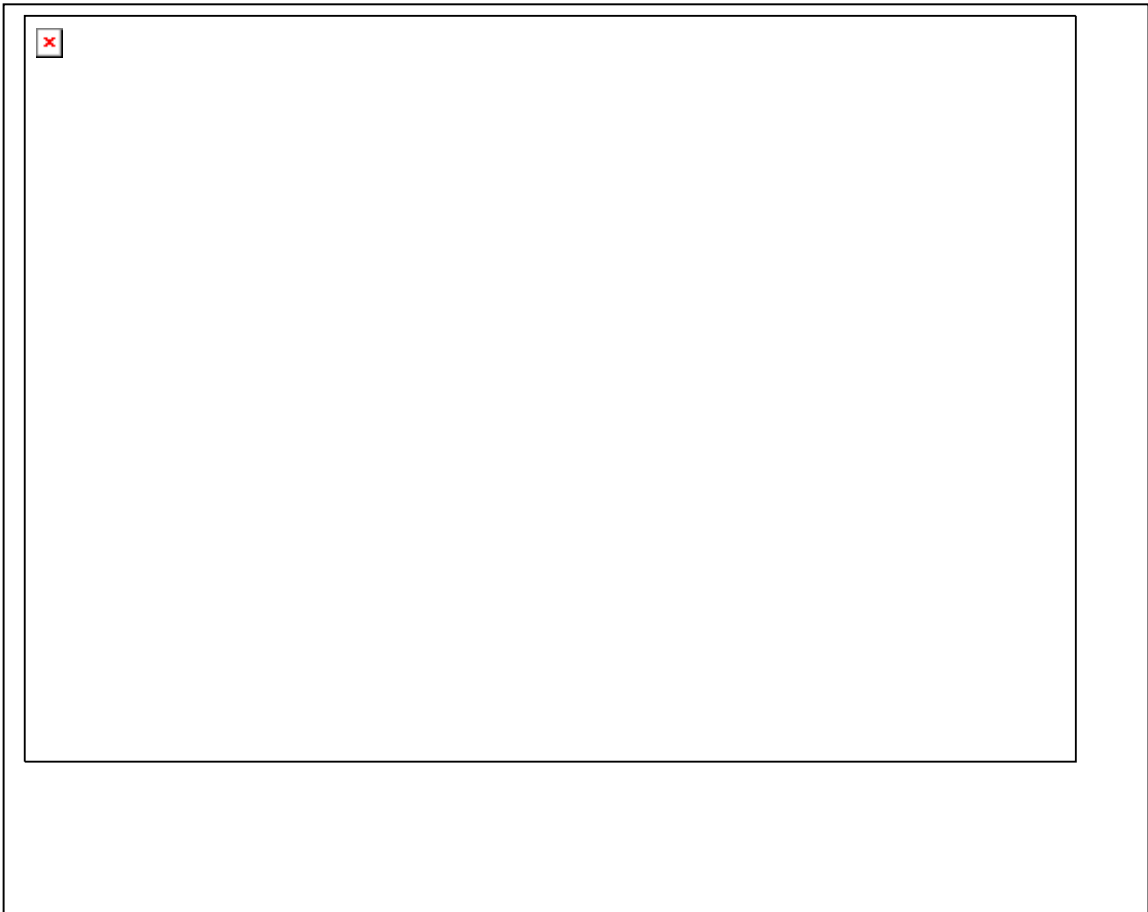
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ts work part time during the school year and full time during the summer months prior to college. According to the Federal Minimum Wage Rates Under the Fair Labor Standards Act, the current minimum hourly wage is \$5.15. Simple math will tell you that if a student works 40 hours per week from May through August, that student will earn \$206.00 week or \$3,296 over the summer. In this example, this student will earn \$876.00 more than the income protection allowance. This is a conservative example since students tend to earn more as they matriculate toward graduation. Considering the cost of consumer goods, few students have discretionary funds.

Types of Aid Offered:

Perhaps the most obvious impact on low-income students who work is the types of aid the students receive. The majority – 71 percent – of the students in this study received a Pell Grant. However, all but 364 received a smaller Pell grant because the student worked or saved, and 153 students or 12% worked or saved so much money that it disqualified them from receiving a Pell Grant. So, while the parents of these students demonstrated a socioeconomic condition that indicated a high need, the student's earnings and savings eliminated them from the largest federally funded grant program.

In a comparison of the breakdown of the students with a contribution greater than zero ($SC > 0$) to those students with a contribution equal to zero ($SC = 0$), students with a zero SC received a larger percentage of scholarships and gift aid. These students also



received the lion's share of the Pell Grants awarded. However, loans were by far the majority aid program awarded to both populations. While this is not surprising, it is disturbing considering the socio-economic status of this population. However, considering the purchasing power of the Pell grant and the rise in cost of education, loans are the only alternative to dropping out of college.

Implications of this Study:

According to *A Nation at Risk, Again*, college enrollment rates are declining among low-income students. It is agreed among most researchers that education is an investment, which increases a student's earning power over the lifetime. According to the National Center for Education Statistics the relationship between work and completing one year of education has an inverse relationship. The more a student works the less likely the student is to complete the first year of education. However, we know that a limited amount of work benefits students and actually assists in persistence toward graduation. About one in five first year students who worked full time were not enrolled for a full academic year, compared with about one in twenty who worked 1 to 15 hours. Knowing this it is critical for legislators to adjust the needs analysis formula so that working students are not penalized for the income they earn. Few families agree that the expected family contribution adequately and accurately accesses the family's ability to pay. Furthermore, financial aid officers would agree that the issue of how student's income and assets are assessed in determining a family's ability to pay for college is a perfect example of how some of the assumptions behind the government's formula do not match the realities of today's students.

We have seen that because of the changing demographics, a weak economy, rising tuition levels, and the proportion of students requiring financial assistance has increased. According to the Lumina Foundation, over 144,000 students will be unable to attend college because of financial difficulty. When the laws were established in the 1970's "many fewer students were working full time while enrolled in college." In addition, as the profile of the nuclear family has evolved over the last twenty years, it is

not atypical to see a low-income student supplementing the income of the parent. Based on outdated federal policies and lack of funding resources, these low-income students are forced to borrow beyond their means. Congress needs to find ways to soften the work penalty for dependent students.