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September 28, 1994

The Honorable Neal Smith
Acting Chairman
The Honorable John Edward Porter
Ranking Minority Member
Subcommittee on Labor, Health and
Human Services and Education
Committee on Appropriations
House of Representatives

This letter responds to the Committee's request for information on cost trends in the Department of Education's Pell Grant Program. As agreed with the Committee's staff, our objectives were to (1) identify patterns in the Department's funding of Pell grants and (2) estimate the incremental budgetary cost of various features of the Pell Grant Program.

We developed our information by obtaining and analyzing program data and estimates from the Department. We did not verify these data and estimates, but did discuss them with the Department's staff, and talked with staff of the Congressional Budget Office. We estimated several budgetary costs for Pell grant awards through our analyses and discussions with Department staff and others in the postsecondary education community. The effect of several legislative changes contained in the Higher Education Amendments of 1992 (P.L. 102-325) were uncertain at the time we did our analyses because in many cases the most recent available data were for the 1991-92 award year or earlier.

BACKGROUND

The Pell Grant Program is the Department of Education's largest student aid program providing grants for postsecondary students, with budget authority of about $5.8 billion for the 1993-94 award year. The Higher Education Act of 1965, as amended, authorized grants to undergraduate students of up to $3,700 for the 1993-94 award year. However, congressional appropriations limited individual grants to $2,300 (called the maximum grant) for the approximately 3.7 million eligible students who received grants.

The Department provides Pell Grant Program funds to postsecondary institutions to award Pell grants to undergraduates using a statutory formula for analyzing students' financial need (termed need analysis). A student's financial need is the amount by which his or her cost of attendance exceeds the expected family contribution (EFC). The EFC is the amount a student or his or her family is expected to contribute toward the cost of attending a postsecondary institution.

The amount is calculated using a statutory formula, which changed substantially as a result of the Higher Education Amendments of 1992. For example, the amendments eliminated requirements that students contribute a minimum amount from their own earnings ($700, $900, or $1,200 depending on the student's status) whether or not they had earnings. The revised formula requires that students contribute 50 percent of any of their income after taxes and other allowances.

The amount of the grant cannot exceed a student's financial need, and the amount typically varies with a student's EFC rather than his or her financial need. The amount of the grant is determined by a federal schedule that provides higher grant amounts to students with lower EFCs. Full-time students with EFCs of zero are eligible for the maximum grant ($2,300 for 1993-94).[1] The minimum grant is $400, and in order to receive a grant the difference between EFC and the maximum grant must be at least $200. If, for example, the maximum grant is $2,300, a student with an EFC of $2,200 is ineligible (the difference is less than $200). If the maximum grant rises to $2,400, the difference between the maximum grant and the student's $2,200 EFC becomes $200. Because the difference is at least $200, the student becomes eligible for the minimum grant of $400.

Pell grants covered an average of 33 percent of recipients' cost of attendance, which averaged $5,320 in the 1991-92 award year (the latest year for which information is available).[2] Pell grant recipients'

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[1]This assumes that the Pell grant recipients' cost of attendance exceeds the maximum grant amount.

[2]Cost of attendance is the cost of education including tuition, fees, room, board, and allowances for books, supplies, transportation, and child care.

EFCs, averaging $1,291 for the year, represented an average of 29 percent of their cost of attendance.[3] The recipients' remaining cost (38 percent on average) was covered by other financial aid, such as Supplemental Educational Opportunity Grants, loans, employment earnings, or reduced spending for items such as books, room, and board. Most of the loans are guaranteed through the Federal Family Education Loan (FFEL) Program, which provided about $18 billion in student loan commitments in fiscal year 1993.

PELL GRANT FUNDING TRENDS

We found Pell grant expenditures increased in most years since 1979-80, but were expected to decline in 1993-94, then rise again (see fig. 1).[4] Budget analysts partially attributed the expected 1-year decline to new provisions concerning independent students--a revised formula for determining EFCs for single independent students without dependents and a revised definition of an "independent student".[5] Many applicants who were previously eligible for Pell grants as independent students either lost their eligibility or received smaller awards.

As shown in figure 1, most Pell grant aid goes to students at 4-year institutions. The proportion of Pell grant aid provided to these students has declined since the early 1980s, while the proportion provided to students at less-than-4-year institutions has increased.

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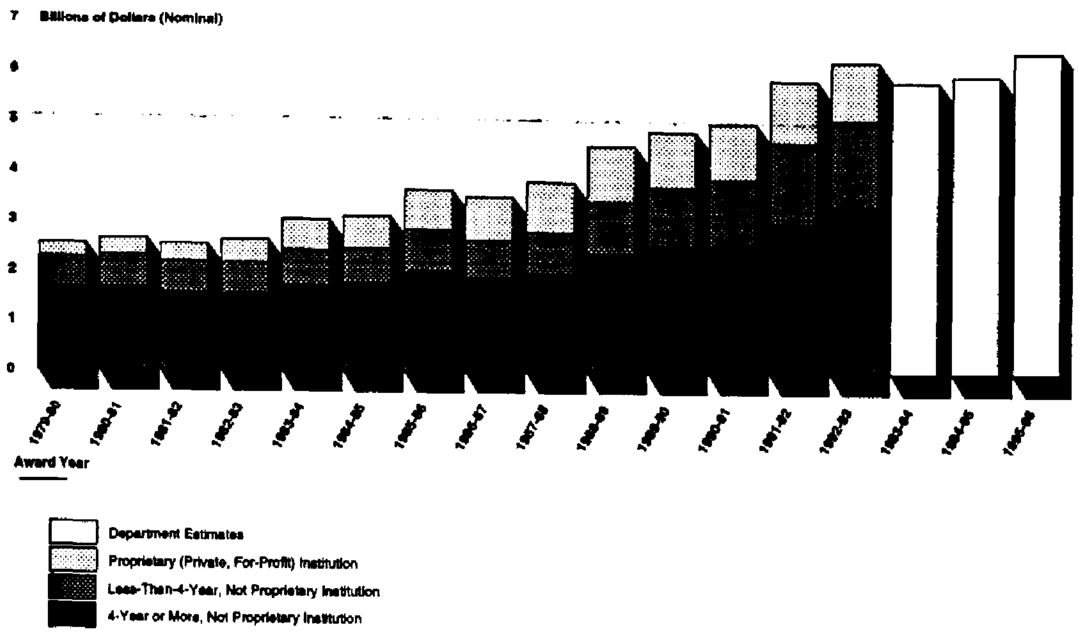
[3]According to the Department's Budget Service, recipients' average 1993-94 EFC was substantially less ($390) due to revisions to the EFC formula.

[4]In constant dollars, Pell grant funding remained approximately level from 1980 through 1987, then increased. See Higher Education: Grants Effective at Increasing Minorities' Chances of Graduating (GAO/T-HEHS-94-168, May 17, 1994), p. 3.

[5]An independent student is one who is at least 24 years old, married, a graduate or professional student, someone with legal dependents other than a spouse, an orphan or ward of the court, or a veteran. The previous definition included single students not claimed as a dependent on their parents' income tax returns in the previous 2 years, who had financial resources of at least $4,000 in each of those years.

Figure 1: Pell Grant Award Dollars by the Type of Institution



ESTIMATED COST OF VARIOUS PELL GRANT PROGRAM FEATURES

For fiscal year 1995, we estimated the incremental costs for various features of the Pell Grant Program, including the cost of raising the maximum grant, the cost of providing Pell grants to various groups of recipients, and the cost of including or excluding selected eligibility factors in the calculation of amounts of grants available to recipients. As shown in table 1, we also identified the estimated incremental number of Pell grant recipients or awards that could be affected by including or excluding each program feature.

Table 1: Incremental Cost of Selected Pell Grant Features

Program feature	Estimated incremental cost for fiscal year 1995 (millions)[a]	Estimated number of recipients affected (thousands)
Increase in the maximum grant amount by $100	$350	3,800
Grants to students in their first year of postsecondary study	3,000	2,000
Grants to students in their fifth or later year of undergraduate study	300	200
Grants to proprietary school students	900[b]	500
Grants to part-time students	500	600
Grants to less-than-half-time students	42	88
Grants to students without a high school diploma, General Education Development Certificate (GED), or equivalent	100	60
Exclusion of the value of the family residence computing the expected family contribution[c]	76	53
Grants to students at schools with loan default rates of 25 percent or more for the 3 most recent years	34	19
Financial aid administrators' authority to use professional judgment in computing the amount of a student's aid	320	334

[a]The incremental cost of a combination of program features generally would not equal the sum of the cost estimates for component features.
[b]This estimate assumes that no proprietary (private, for-profit) institution students would attend nonproprietary institutions to receive a Pell grant.
[c]These estimates concern recipients that would lose eligibility if these provisions were repealed. In addition at most 400,000 recipients would receive smaller grants.

The features of the program discussed here were established by legislation, and changes could result in the denial of grants to some students who depend on them to help defray the cost of their education. In some cases, the effect of excluding students from the Pell Grant Program or reducing the amount of their grants could be to dissuade students from pursuing their postsecondary education.[6]

The Maximum Amount of Pell Grants

The cost of increasing the maximum Pell grant amount (which was $2,300 in the 1993-94 award year based on funds appropriated) by $100 could be an estimated $350 million in the 1995-96 award year. Nearly all of the 3.9 million students who are expected to receive Pell grants in the 1995-96 award year would benefit from a $100 increase.

According to Department analysts, a $100 increase or decrease in the maximum grant amount increases or decreases the number of eligible students by approximately 50,000. If, for example, the maximum grant had been $2,200 and rose to $2,300, students with EFCs from $2,001 to $2,100 would become eligible. With the maximum grant at $2,200, they are ineligible because their EFCs are within $200 of the maximum grant. With the maximum grant increased to $2,300, the difference is at least $200, so they become eligible for the minimum grant.[7]

Student Eligibility by Year in School

First-year students receive the largest share of Pell grants. We estimate that in fiscal year 1995, Pell grant awards to first-year students could total about $3 billion. They account for about 60 percent of Pell grant funds. The cost of grants to recipients in their second year of postsecondary education, about 20 percent of recipients, is expected to be about $1.1 billion. Recipients in their third or fourth year, about one-fifth of recipients, could receive about $1.2 billion.

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[6]See GAO/T-HEHS-94-168, p. 1.

[7]This assumes that the students attend full time and that their cost of attendance exceeds the maximum grant.

We estimate that Pell grants to students in their fifth or later year of undergraduate study could cost about $300 million in fiscal year 1995. Generally about 4 percent of Pell grants are awarded to these students. The law permits a student to receive Pell grants for more than 4 years if additional time is required to complete an undergraduate degree and the institution determines the student is making satisfactory academic progress. In 1993-94 an estimated 157,000 Pell grant recipients were in their fifth or later year of undergraduate instruction. This included students who had attended school on a part-time basis in prior years.

Students at Proprietary Institutions

We estimate that the incremental cost of Pell grants to students attending proprietary (private, for-profit) institutions could be about $900 million in fiscal year 1995. This estimate assumes, however, that none of the students currently expected to attend a proprietary institution would instead attend a nonproprietary institution to receive a Pell grant.

The amount of Pell grant awards to students enrolled in proprietary institutions did not grow during the early 1990s as it did in the 1980s. These awards increased steadily from $262 million in award year 1979-80 to $1.1 billion in 1989-90. Since then, annual Pell grant expenditures awarded to students attending proprietary institutions ranged between $1.1 billion and $1.2 billion.

Part-Time Students

Pell grants to part-time students (including three-quarter-time, half-time, and less-than-half-time students) could cost approximately $500 million in fiscal year 1995. These students have received an estimated $745 million in Pell grant awards in 1993-94 (an estimated 13 percent of Pell grant expenditures). The estimated incremental cost of providing grants to these students is, however, only $500 million because some students could choose to enroll full time to be eligible for Pell grants. An estimated 800,000 recipients could be part-time students in 1995-96, however, we assumed that about 200,000 of these students would attend school full time if Pell grants were not available for part-time students.

The Department's Budget Service estimated the cost for recipients enrolled in postsecondary institutions as less-than-half-time students at $42 million in fiscal year 1995. Department staff estimated that about 88,000 less-than-half-time students will receive Pell grants in award year 1995-96.

Ability-to-Benefit Students

The estimated incremental cost of Pell grants to students without a high school diploma, a General Education Development Certificate (GED), or the equivalent could be about $100 million in 1995-96. However, this estimate relies in part on estimates of the proportion of students without these credentials in 1989-90 (the latest year this information was available). These provisions could affect approximately 60,000 recipients, most of whom would attend proprietary institutions.

Before 1991, postsecondary institutions could award grants to students without these credentials if they concluded, based on the results of a test, that the students had an "ability to benefit" from education at the institution. The schools could select a nationally recognized, standardized, or industry-developed test and administer it themselves to prospective students.

Legislation in 1990 and 1991 imposed new provisions that may make it more difficult for some ability-to-benefit students to obtain Pell grants.[8] To be eligible for Pell grants, students without a diploma, a GED, or the equivalent must either meet state requirements (in the state in which the school is licensed to operate) approved by the Department or pass a test approved by the Department. The Department-approved test must be administered by an independent third party rather than by employees of the postsecondary institution. Department staff said these provisions have reduced the number of students without high school diplomas or GEDs receiving Pell grants. However, data supporting this conclusion are not yet available.

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[8]Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) and the Higher Education Technical Amendments Act of 1991 (P.L. 102-26).

Value of Family Residences in Student Aid Calculations

According to Department analysts, program provisions that exclude the equity in a principal family residence in calculating EFC affects the eligibility of an estimated 53,000 recipients in 1995-96 at a cost of about $76 million. At most 400,000 additional recipients receive higher grants as a result of these provisions. Consistent with federal requirements, the calculation of a Pell grant applicant's EFC considers the family income and some family assets, such as savings and checking account balances.

Before the 1992 amendments, the net value of a family's principal place of residence was considered in calculating an applicant family's assets. However, the 1992 amendments eliminated the value of a principal residence in EFC calculations. As a result of this revised provision, beginning in the 1993-94 award year Pell grant applicants' EFCs are lower, making some students eligible who would not otherwise be eligible or making them eligible for larger grants.

Students at Institutions with High Default Rates

Pell grants for students at institutions that have high student loan default rates could cost an estimated $34 million in fiscal year 1995, according to the Department's Budget Service.[9] This is considerably less than the $200 million to $300 million in Pell grants that students at these institutions received in the 1991-92 award year. Department analysts believe that eliminating Pell grants to students at these schools will not reduce program costs by the amount of Pell grants provided to students at these institutions because

-- many of the students eligible for Pell grants could transfer to institutions that award Pell grants;

-- some of these high-default-rate institutions could close because under existing statutory provisions they

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[9]This is an estimate for institutions that could become ineligible for the FFEL Program because their default rates (computed in accord with the Higher Education Act of 1965, as amended) exceed 25 percent in each of the 3 most recent years for which data are available.

could lose their eligibility for the FFEL Program (whether or not they remain eligible for Pell grants); and

-- the Department's Budget Service assumed that Pell grant recipients at Historically Black Colleges and Universities and tribally controlled community colleges with high default rates would continue to receive grants because it assumed these institutions would be exempt from default rate provisions as they are from similar provisions in the FFEL Program.

Some schools are challenging the accuracy of the student loan default rates the Department uses to discipline schools. Some of these schools have obtained court orders delaying the Department's use of high default rates (rates exceeding statutory thresholds) as an enforcement mechanism. A major theme of these cases is that the Department allegedly has not, as required by law, excluded from its default rate calculations loans which defaulted because of improper servicing and collection practices by lenders or loan servicers. The schools' position is that the failure to exclude these loans causes their default rates to be erroneously inflated above the thresholds and this is causing the schools to be unfairly punished. The Department and schools continue to debate this issue in several U.S. district courts.

Financial Administrators' Judgment in Adjusting Aid Calculations

Program provisions that allow school financial aid administrators to use their professional judgment in calculating students' EFCs could cost an estimated $320 million in fiscal year 1995, according to Department analysts. This could affect Pell grant awards for about 334,000 recipients.

The law permits financial aid administrators to use their judgment in making EFC determinations under special circumstances. Department guidance to schools illustrates examples of special circumstances that include a family's unusually high medical/dental expenses, tuition expenses at an elementary or secondary school, and loss of a job. The 1992 amendments expanded the administrators' authority, allowing them to adjust the factors they use to reflect special circumstances in calculating students' Pell grant awards. For example, they can change the dependency status of Pell grant applicants, or modify one of the factors used in computing their EFCs, as long as administrators document the special circumstances warranting these changes.

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Copies of this letter are being sent to the Secretary of Education, appropriate congressional committees, and other interested parties. Please call me at (202) 512-7014 if you or your staff have any questions. Major contributors include Joseph J. Eglin, Jr., Assistant Director, (202) 512-7009, Benjamin P. Pfeiffer, Irene H. Botero, Cheree D. Desimone, Charles M. Novak, and Dianne L. Whitman.

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