Exploring Ways to Enhance FAFSA Efficiency:

Understanding the Impact of Different Methods for FAFSA Simplification

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NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

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Overview

Fourteen years ago, Susan Dynarski and Judith Scott-Clayton published their groundbreaking analysis of the costs of complexity in the financial aid application and award system and the potential benefits of radical simplification.[1] Since then, advocates, researchers, and policymakers have put forward numerous proposals for making it easier for students to predict and qualify for student aid.

Applicants now complete the Free Application for Student Aid (FAFSA) almost entirely online. It has fewer questions and more skip logic, and some information can be imported directly from the IRS. But the process remains daunting for many students and families, and the formula for computing Expected Family Contributions (EFCs) on which eligibility for federal aid, as well as much state and institutional aid, is based remains complicated and confusing.

After summarizing reform proposals currently before Congress, this paper reviews the evidence generated by multiple researchers testing various modifications of the Federal Methodology (FM)—the formula that manipulates data from the FAFSA to come up with an index of ability to pay for all applicants. Reducing the amount of information on which calculations are made could have a significant impact on measurements of ability to pay for more affluent households but would have minimal impact on those in the income range of eligibility for Federal Pell Grants.

I argue that additional modeling of minor variations on the approach to simplification is unlikely to yield important new insights. We know that it is possible to develop a simple look-up table for Pell Grants without imposing significant costs on either current recipients or taxpayers. And we know which household characteristics should trigger requests for additional financial details in order to equitably distribute aid.

A very simple Pell Grant allocation system will improve college access for low-income students, but some states and institutions that choose to subsidize students from middle- and upper-middle-income households will need more information to ensure the effectiveness of their aid dollars.

I raise questions about a revised EFC formula, preferably based largely on information from the IRS, that would provide the basis for the allocation of other student aid once a separate, very simple Pell allocation formula is implemented. Existing data provide some evidence about the potential impact of different approaches to such a formula, but rigorous modeling efforts would provide additional insights.

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[1] Susan Dynarski and Judith Scott-Clayton, "The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics." *National Tax Journal*, 59, no. 2, (2006) 319–356.

Numerous proposals for simplifying the student aid system are before Congress.

At least 10 bills related to the FAFSA have been introduced during the current session of Congress. Most proposals focus on simplifying the application process, making it easier for the IRS to share data with the U.S. Department of Education (ED), and easing demonstration of eligibility for automatic-zero EFC (auto-zero), which allows many low-income students to qualify for the maximum Pell Grant without providing detailed financial data. These proposed approaches would likely increase the number of students who complete the FAFSA and receive federal student aid but would not have much impact on which filers are eligible for Pell Grants. However, a few of the bills in Congress—as well as numerous proposals from student aid advocates—would modify the formula in the FM, affecting whether those who complete the FAFSA are eligible for Pell and if so, the amount of aid for which they qualify.

The Fostering Undergraduate Talent by Unlocking Resources for Education (FUTURE) Act of 2019, signed into law in December 2019, simplifies the financial aid application and verification processes. The FUTURE Act allows the IRS to disclose tax return information directly to authorized officials of ED for the purpose of determining eligibility for federal student aid. In addition to the information currently included in the Data Retrieval Tool, through which FAFSA filers import limited IRS data, this information includes whether an individual filed a federal income tax return, their filing status, and whether the return includes any tax schedules required for more complicated financial circumstances.

Other current bills focus on the following issues:

• Improving data sharing between ED and the IRS

• Expanding access to the auto-zero EFC by

     o Making receipt of a federal means-tested benefit program a sole qualifier

     o Raising the income threshold for eligibility and indexing it to inflation

• Codifying reliance on prior-prior-year (the calendar year two years before the academic year during which the aid will be used) tax information and earlier FAFSA filing, which are practices implemented by executive order in 2015

• Removing from the FAFSA questions unrelated to aid determination by

     o Removing the question about drug offenses and eliminating the restriction on aid eligibility for students convicted of drug offenses

     o Eliminating the question about Selective Service registration

- Simplifying the EFC calculation by

    o Making Pell eligibility a function of just two variables—adjusted gross income (AGI) and household size

    o Modifying the aid application process to create three pathways for calculating EFC, with recipients of federal need-based programs eligible for auto-zero and those with incomes below $60,000 and not required to file lettered tax schedules able to rely solely on data provided by the IRS. Only applicants not meeting these criteria would be required to provide information about income and assets

    o Eliminating some forms of untaxed income from consideration in calculating the EFC

    o Eliminating the requirement to list assets on the FAFSA if tax returns do not indicate significant asset holdings

- Making DREAMers eligible for Title IV aid

- Simplifying the process for students who are unable to provide parent information because of specified extenuating circumstances

- Allowing the FAFSA filed when a student is first enrolling to qualify Pell recipients for that aid throughout their undergraduate programs unless their dependency status changes

A simpler process might increase the number of FAFSA filers.

Easier exchange of data between the IRS and ED or loosened restrictions on qualifying for the auto-zero EFC do not create Pell losers—only winners. This reality, combined with the possibility that a simpler process should encourage more aid-eligible students to complete the FAFSA, raises questions about the impact of simplification on the cost of the Pell program. Most existing simulations of necessity abstract from the potential magnitude of this behavioral change.

According to data from the National Postsecondary Student Aid Study (NPSAS 2016), only 9% of 2015–16 undergraduates who did not apply for federal aid cited the work involved in completing the forms as a reason for not filing. Half thought they would not be eligible, and 44% said they had no need. This result raises questions about how much simplifying the process will increase FAFSA completion, but it is not clear how reliable these data are.

Since the Pell program functions as though it were an entitlement, there is little reason to be concerned about the increased eligibility leading to budget constraints. In 2017–18, 4.5 million FAFSA filers had $0 EFCs; 2.1 million students received the maximum Pell Grant. (Others who qualified were not enrolled full time full year.) If that number increased by 10%, with 210,000 new Pell recipients receiving the maximum grant, the total cost of the program would rise by about $1.3 billion—4–5% of current expenditures.

If increased cooperation between the IRS and ED prevents most students—or at least most of those who are Pell eligible—from having to provide financial data on the FAFSA, and if the verification process becomes less burdensome as a result, many observers will consider the problem of FAFSA complexity largely solved. Eliminating questions not directly relevant to aid eligibility, such as those relating to drug offenses and Selective Service registration as proposed in several bills currently in Congress, would further mitigate the problem. But simplifying the formula is also critical for making it possible for students to predict how much aid they will receive and make college decisions with confidence that they will have financial support.

Considerable evidence about the potential impact of many of these changes is already available.

Even if the application process is dramatically simplified, there are strong arguments for simplifying the formulas for determining both Pell eligibility and EFCs. The current formula is difficult for students—and even financial aid administrators—to understand. It also makes it impossible for students and families to predict how much aid they will receive. A number of researchers have modeled a range of potential changes. There is broad consensus that relying on only a few data elements would have little impact on the allocation of Pell Grants. Many of those receiving this aid have $0 EFCs so their aid eligibility usually does not change when items are eliminated from the formula. However, eliminating data elements could modify EFCs much more for higher-income households, most of whom don't qualify for federal need-based aid.

It is useful to review and synthesize the results of these models to create a clear picture of the potential impact of changing the FM.

Susan Dynarski and Judith Scott-Clayton pioneered the modeling of the impact of FAFSA simplification, measuring the influence of various data elements on the level and distribution of aid.[2] One of their simulations used the AGI of the parents (or, for non-filers, earnings), students' earnings, parents' and students' assets, parents' marital status, family size, and number of family members in college. These variables explained 90% of the variation in the Pell Grant, 93% of the variation in the EFC, and 79% of the variation in subsidized Federal Direct Loan eligibility. The authors suggested that using only these items would cut the number of financial questions on the FAFSA by more than 80%, while changing the Pell Grant by less than $500 for 88% of recipients. Even a very simple model, with Pell Grant eligibility based solely on parents' AGI, explained 75% of the variation in current Pell Grants. On average, Pell Grants would increase by $53 per student.

[2] Susan Dynarski and Judith Scott-Clayton, "The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics." *National Tax Journal,* 59, no. 2, (2016) 319–356.

Dynarski and Scott-Clayton found that excluding student earnings from the calculation of aid would have a larger impact on Pell eligibility than excluding other individual data elements. The model predicted that keeping the current formula but dropping student earnings would increase average Pell Grants by about $500 for those from families with incomes between $15,000 and $45,000. Using data from 2003–04, the authors reported that a larger share of students from lower-income families than from higher-income families had positive earnings and that earnings were somewhat lower for those from more affluent families.

However, data from the 2015–16 NPSAS show a different pattern. As Dynarski and Scott-Clayton noted, it is important to measure changes in Pell eligibility and EFCs in relation to parents' incomes rather than current EFCs. The current EFC formula counts some families as "richer" simply because their college students work more hours. If students at different income levels earn similar amounts, these earnings generate much larger percentage increases in family income levels for those with low parental incomes than for those with higher parental incomes.

In 2015–16, earnings were least common among lower-income dependent students and most common among those whose parents were in the upper half of the income distribution. Middle-income students with earnings had the highest incomes, but the differences were relatively small (Table 1). This pattern suggests eliminating student earnings from the calculation of the EFC would lower EFCs most for dependent students in the upper half of the income distribution who would remain ineligible for Pell Grants. However, ignoring these earnings could raise institutional aid for higher-income students relative to others.

Table 1: 2014 Earnings of 2015–16 Dependent Students, by Parents' Income

Parents' income	Share of dependent students with income	Average income per student	Average income per earner
Less than $27,900	44%	$3,283	$7,392
$27,900-62,999	64%	$4,912	$7,706
$63,000-113,499	71%	$5,462	$7,743
$113,500 or more	72%	$5,006	$6,982

Source: NPSAS 2016, Power Stats, https://nces.ed.gov/datalab/index.aspx

Dynarski and Scott-Clayton proposed implementing a standard contribution for all dependent students, eliminating the disincentive to work while avoiding a significant increase in Pell eligibility. This idea is appealing regardless of how the distribution of student earnings evolves over time.

Adding to the evidence about the potential impact of simplifying the need analysis formula, a 2012 College Board study used 2007–08 FAFSA data from five states (Kentucky, Minnesota, Ohio, Texas, and Vermont) to examine the potential impact of FM simplification on EFCs, Pell awards, and state grant eligibility. The authors noted that the 2009–10 changes to the FM that dropped consideration of earned income tax credits, additional child tax credits, welfare benefits, and untaxed Social Security benefits reduced EFCs for some filers. The study's estimates suggested that this change increased the share of filers receiving Pell Grants by about 1 percentage point and total Pell Grant awards by 4 to 5%.[3]

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[3] Sandy Baum, Kathleen Little, Jennifer Ma, Anne Sturtevant (2012), *Simplifying Student Aid: What It Would Mean for States,* College Board. https://eric.ed.gov/?id=ED531673

The study also modeled the impact of removing all assets from the formula and of relying entirely on a small number of data elements available from the IRS: AGI, federal taxes paid, and number of exemptions claimed. Because the data required to calculate the employment expense allowance are not available from the IRS, this component of the formula was not included, raising EFCs for some students.

According to the simulations, removing assets from the formula would lead to an increase of roughly 1 to 3 percentage points in the share of filers eligible for a Pell Grant in each state. This change would have a more significant impact on EFCs for higher-income students. For example, for dependent filers enrolled at Texas public institutions, the average decrease in EFC was $73 for those with family incomes below $15,000, $414 for filers with incomes between $45,000 and $60,000, and $1,946 for those from the highest-income backgrounds. In Vermont, the average EFC would decline by $468 for dependent filers with incomes below $15,000 and by $3,181 for those with incomes above $75,000.

The impact on Pell Grants was much smaller, since most filers who would be significantly affected by the elimination of assets are not Pell recipients. For example, in Minnesota, the overall average EFC would fall by $1,350, but the average decline for Pell recipients would be just $1.

EFC decreases for independent students with dependents averaged less than $100 per filer for all states studied. Declines in EFC were somewhat larger for independent students without dependents because of the higher assessment rate the need analysis system applies to their assets. Still, the average Pell Grant increase for independent filers without dependents ranged from $5 in Texas to $23 in Vermont. Among Pell Grant recipients, the change in the average award was no more than $5 in any state studied.

Eliminating assets from the FM would also have a relatively small impact on overall eligibility for state grants. The percentage increase in total state grant eligibility, assuming all eligible students were funded, would range from 0.7% in Minnesota to 4.5% in Vermont—a range similar to the predicted increase in Pell eligibility.

The simulations in the study indicated that relying only on IRS information on AGI, federal taxes paid, and number of exemptions would have little impact beyond the removal of assets. Again, only at higher income levels would EFCs be significantly affected.

Average declines in EFCs among dependent filers from families with incomes above $75,000 ranged from $2,515 in Kentucky to $4,294 in Vermont. These changes were larger than those resulting from the simple removal of assets from the FM because some income sources currently collected on the FAFSA, both taxed and untaxed, were excluded in determining expected contributions. The model based on this limited data indicated that the average Pell Grant per dependent filer would decrease in some states by amounts ranging from $8 to $33 and increase in other states by up to $45. Relying only on these limited data elements would lead to an increase of 0 to 2 percentage points in the proportion of dependent FAFSA filers in each state eligible for Pell Grants. As was the case with eliminating assets, the impact of using only a few IRS data elements was much more significant for dependent filers than for independent filers, both with and without dependents.

Because of concerns that even small increases in the share of FAFSA filers eligible for Pell Grants and in average award levels could have measurable impact on the federal budget, the College Board study modeled formula modifications that could make the simplification strategies revenue neutral. For example, raising each assessment rate by 3 percentage points or combining the two lowest rates and slightly narrowing the income brackets would effectively counteract the impact of more limited data on the average calculated EFCs of parents and independent students with dependents. In other words, the federal government could simplify the FAFSA and the formula for calculating EFCs without generating a significant increase in aid applicants' measured need.

A third set of simulations from an Urban Institute study used data from the 2011–12 NPSAS to model the cost and distributional impacts of several proposals for simplifying the need analysis methodology.[4] The study modeled five different simplification proposals for determining Pell Grant eligibility based on some combination of income, family composition and size, and number of family members attending college. It also modeled three alternatives for calculating EFC, asking how each would affect the distribution of aid and the cost of the Pell program.

In order to facilitate the creation of simple look-up tables for Pell, Urban researchers tested the impact of eliminating the practice of dividing the EFC by the number of students in a family who are in college.[5] They found that there would be more than 270,000 fewer students eligible for Pell, with students in higher-income households losing eligibility, leading to a decline in program costs of almost a billion dollars.

Some of the proposals this study examined would modify the EFC formula, as opposed to creating a simple Pell allocation system. For example, like Dynarski and Scott-Clayton, the researchers tested excluding contributions to EFC from dependent students and found program costs would increase by over $500 million.

The Urban Institute modeled the 2015 National Association of Student Financial Aid Administrators (NASFAA) proposal for three paths for EFC determination that is the basis for a number of bills currently before Congress. One path would ensure that households receiving federal benefits would automatically receive a maximum Pell award. For the second path, the proposal adds in a limited amount of additional untaxed income such as child support payments and untaxed pension and retirement payments. The third path uses a different formula for taxpayers with complicated returns.

The Urban Institute authors concluded that splitting out the Pell Grant calculation from the rest of the federal aid application process was optimal. This strategy would create a simple and predictable Pell Grant system, while allowing states and institutions distributing aid farther up the income scale to equitably differentiate among applicants. The proposed approach would use a formula like that generating a Pell look-up table based on two data elements while maintaining a simplified EFC calculation for other types of aid. Basing Pell on income relative to the federal poverty level (FPL), which varies with family size, would incorporate family size without complicated alternative calculations. This strategy is similar to that incorporated in the Financial Aid Simplification and Transparency (FAST) Act, first proposed in 2014 by U.S. Senators Lamar Alexander (R-TN) and Michael Bennet (D-CO) and several cosponsors.

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[4] Kim Rueben, Sarah Gault, and Sandy Baum *Simplifying Federal Student Aid: An Overview of Eight Plans,* (Urban Institute, 2015), https://www.urban.org/research/publication/simplifying-federal-student-aid-overview-eight-plans

[5] As argued in the author's other paper in this series, *The Federal Methodology: Is It a Good Measure of Ability to Contribute Toward Educational Expenses?*, the current number-in-college adjustment creates horizontal inequity among families in similar financial circumstances with the same number of children by significantly altering aid eligibility depending on the spacing of the children.

In later work, the Urban Institute researchers addressed the decline in Pell eligibility they found this approach could generate for small households, particularly independent students with a child. Small families accounted for more than half of the recipients who would receive smaller awards under the formula based on only two data elements. They modeled an alternative formula that would use the FPL for a family size of four rather than for the actual family size (of two or three) for families in which the student is dependent or is independent with a dependent child.[6] This approach increased the share of Pell recipients for whom the grant amount would change by less than $500.

There are clear takeaways from this body of work from different researchers. Despite small differences in impact, none of the approaches proposed for simplifying the student aid allocation system would have a major impact on the Pell Grant program. Some changes—such as eliminating the adjustment for number in college—have the potential to significantly diminish the number of students from relatively affluent families who receive Pell Grants. It does not require a detailed simulation to predict this outcome.

Eliminating income not included in AGI or eliminating all assets would increase eligibility for some aid applicants without having the opposite impact on any others. Clearly, with no other changes, the cost of the program could increase. However, all of the available simulations suggest that the change would be relatively small. Moreover, it would not be difficult to modify the eligibility criteria to make the changes revenue neutral. For example, if a simple table is implemented where Pell awards decrease as the amount of income relative to the federal poverty level increases, lowering the threshold for the maximum grant or increasing the rate at which Pell declines as income increases could make the change revenue neutral.

One explanation for the predicted minimal impact on Pell awards if the formula is dramatically simplified is that a large share of recipients already has a $0 EFC. Removing income and/or assets from consideration will not lower their EFCs. Almost two-thirds of 2017–18 Pell Grant recipients were eligible for the maximum Pell Grant based on the current FM formula. This included 54% of dependent recipients, 64% of independent recipients without dependents, and 82% of independent recipients with dependents (Table 2).

Table 2: Share of 2017–18 Pell Recipients with $0 EFCs

Pell Recipients	Share with $0 EFC
All	64%
Dependent	54%
Independent without dependents	64%
Independent with dependents	82%

Source: U.S. Department of Education, Pell Grant End-of-Year Report 2017–18, Table 4, https://www2.ed.gov/finaid/prof/resources/data/pell-data.html,

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[6] Kim Rueben, Sarah Gault, and Sandy Baum, *Simplifying Federal Student Aid: A Closer Look at Pell Formulas with Two Inputs*, (Urban Institute, 2016), https://www.urban.org/research/publication/simplifying-federal-student-aid-closer-look-pell-formulas-two-inputs.

There are, of course, possible changes to the formula that could reduce eligibility for Pell Grants among low- and moderate-income filers. For example, the current employment expense allowance reduces available income for parents of dependent students and independent students with dependents who are either two-earner households or single working parents. Eliminating that provision could reduce eligibility for some current Pell recipients, but as the simulations show, the impact would not be large, and the other changes would counteract it.

Another finding common to all of the simulations is that a dramatically simplified formula for calculating EFCs, which would have minimal impact on low-income aid applicants, would significantly reduce EFCs for some more affluent households. This outcome does not interfere with the equitable allocation of federal grant aid because students from these families are generally not eligible for federal aid in any case. But it could create significant problems for institutional grant programs and possibly for some state grant programs. Again, it does not require additional simulations to understand this prediction.

It is important to note that these simulations do not incorporate behavioral changes. The models all suggest that dropping assets would not have much impact on federal aid eligibility. However, families with substantial assets who do not currently bother applying for aid might complete the FAFSA if assets are completely excluded from the aid formula, and some of them might become eligible under a simplified formula. Also, a larger number would likely become eligible for need-based institutional aid at institutions with high tuition levels if a more detailed EFC does not provide the basis for allocating aid beyond the Pell Grant.

We need more analysis of other potential changes that promise to make the computation of EFCs more equitable.

Despite the strong consensus in the results of rigorous simulations of a range of approaches to simplifying the determination of Pell awards and the calculation of EFCs, a number of potential modifications to the formula deserve further attention.

These issues include:

• Examining the merits of basing eligibility for Pell Grants and/or EFC calculations on multiple years of income and of eliminating the requirement that students file a new FAFSA for each year of study

• Coordinating the auto-zero EFC and the simplified needs test with the EFC formula

• Expanding the definition of assets included in the EFC calculation to include home equity

• Including non-custodial parents in the estimation of family financial capacity

The discussion below reviews existing evidence relevant to these issues and suggests that further modeling of potential changes to the EFC would be constructive.

Understanding how stable household incomes are is important both for predicting the impact of discontinuing the requirement for aid recipients to file a new FAFSA every year and for considering the possibility of basing EFCs on multiple years of income.

Another way to simplify the federal student aid application process is to allow students to complete the FAFSA once, not requiring renewal applications unless there is a significant change in circumstances. The requirement to reapply generates considerable paperwork for students, institutions, and the federal government. It also creates uncertainty for students about whether they will continue to receive aid and adds deadlines that they could miss.[7] Among second-year undergraduates in 2015–16, 13% of those who previously received Pell Grants did not complete the FAFSA to apply for aid for their second year.[8]

The Center for American Progress (CAP) modeled the potential impact of a one-time FAFSA, collecting data from 27 colleges around the United States for nearly a quarter of a million students who filled out the FAFSA at least twice between 2010 and 2017.[9] The sample is not nationally representative, but one-third of all students in the study had no change to their EFC while enrolled, and for half of all students who applied for aid, EFCs changed by $500 or less for the duration of their enrollment. EFCs were more stable for lower-income applicants, changing by $500 or less for 70% of Pell recipients. Independent students, particularly those with dependents, were especially likely to have stable EFCs.

Small EFCs are stable partly because households with a wide range of low incomes have $0 EFCs, but also because low incomes are likely to change by small dollar amounts year-to-year. However, moving higher up the income scale, incomes fluctuate by large dollar amounts.

In the CAP study, within each dependency category, Pell recipients were much less likely than non-recipients to have large changes in EFC. For example, 19% of dependent non-recipients had declines in EFC of $5,000 or more and the same share had increases of $5,000 or more. Among Pell recipients, these figures were less than 1% and 5% (Table 3).

The CAP report concluded that a one-time FAFSA would ease the burden, especially for low-income and independent students. To diminish inaccuracies, the authors recommended requiring students to refile if family circumstances change or if income changes by $7,000 to $10,000 or more. They also suggested relying on average income over a few years rather than just one year of information.[10]

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[7] Colleen Campbell, *One and Done: Modeling a One-Time FAFSA,* (Center for American Progress, 2018), https://www.americanprogress.org/issues/education-postsecondary/reports/2018/11/26/460723/one-and-done/

[8] NPSAS 2016 Power Stats

[9] Campbell, *One and Done: Modeling a One-Time FAFSA.*

[10] Ibid.

Table 3: Average Changes in EFCs over Duration of Enrollment in Center for American Progress Study

Change	Share of filers	Share of Pell recipients	Dependent			Independent without dependents			Independent with dependents		
			All	Pell	No Pell	All	Pell	No Pell	All	Pell	No Pell
Decline > $5,000	6%	0%	8%	< 1%	19%	5%	< 1%	20%	1%	0%	22%
-$2,501 to -$5,000	5%	1%	5%	1%	11%	6%	3%	16%	2%	< 1%	18%
-$1,001 to -$2,500	7%	4%	7%	4%	11%	9%	7%	15%	3%	2%	16%
-$501 to -$1,000	4%	4%	4%	4%	4%	5%	5%	6%	3%	3%	6%
-$1 to -$500	7%	8%	8%	10%	5%	6%	6%	7%	5%	5%	6%
$0	35%	52%	22%	38%	<1%	40%	52%	< 1%	71%	76%	< 1%
$1 to $500	8%	10%	10%	14%	5%	6%	6%	7%	5%	5%	5%
$501 to $1,000	5%	5%	6%	7%	5%	5%	4%	6%	3%	2%	3%
$1,001 to $2,500	9%	8%	10%	10%	10%	9%	9%	10%	3%	3%	8%
$2,501 to $5,000	6%	5%	8%	6%	10%	6%	6%	6%	2%	2%	7%
Increase > $5,000	8%	4%	11%	5%	19%	5%	4%	7%	2%	2%	9%

Source: Colleen Campbell, *One and Done: Modeling a One-Time FAFSA,* Center for American Progress, 2018.

Researchers at the Urban Institute also simulated the impact of relying on prior-prior year (PPY) data.[11] This study used information from aid applicants for whom income data from both 2010 and 2011 were available from the FAFSA. They found that using PPY income and tax form information from 2010 rather than 2011 for the 2012–13 applicants would increase both the number of recipients and the total cost of the Pell program by about 2%. Any minimal cost increases could be eliminated by adjusting the relevant income levels for a given size of award.

NASFAA carried out a similar study, comparing the impact of moving from 2012 to 2011 income data in determining eligibility for aid for the 2013–14 academic year.[12] Families, especially low-income families, were almost as likely to have higher as lower incomes in the prior year. Overall, 72% of dependent students, 71% of independents with dependents, and 59% of independent students without dependents would not see any change in their Pell awards. Only 14% of independent students with dependents would see a Pell award change of $1,000 or more. However, about 16% to 18% of students overall would see changes in their Pell Grant awards of more than $1,000, with low-income students least likely to see changes in their Pell eligibility.

[11] Rueben, Gault, and Baum, Simplifying Federal Student Aid: A Closer Look at Pell Formulas with Two Inputs.

[12] National Association of Student Financial Aid Administrators, A Tale of Two Income Years: Comparing Prior-Prior Year and Prior-Year Through Pell Grant Awards, 2013, https://www.nasfaa.org/uploads/documents/ppy_report.pdf

The estimates for EFC vary more than those for Pell, in large part because there is more variance for students with higher incomes. For students with an EFC of zero and maximum Pell awards, variations in income are unlikely to affect the size of Pell awards or EFC. EFCs were within $500 of the baseline for 80% of students with incomes under $30,000 in 2012–13. For students further up the income distribution, EFCs changed more with the move to earlier income data.

Another analysis compared estimates of 2012 aid using 2010 data instead of 2011 data.[13] For 70% of applicants, Pell Grant eligibility did not change at all, while for 81% it changed by less than $500. Overall, the average Pell Grant increased by $37 from a baseline of $2,515.

These studies examining the potential impact of the change from prior year to PPY for determining eligibility for student aid provide some indication of the value of using multiple years of income data to determine eligibility. Advocates of the switch to PPY were focused on the idea that incomes are not that different from one year to the next. Multiple studies found this to be the case for Pell recipients, but found larger changes in EFC farther up the income scale.

The argument that the distribution of aid would be more equitable if it were based on multiple years of income data is rooted in the idea that one year is not necessarily representative of long-term income and financial capacity. Data from the Survey of Income and Program Participation (SIPP) provide some insight into how household incomes fluctuate from year to year.

A 2017 study of income stability from 2009 through 2012 found that 57% of households remained in the same quintile between 2009 and 2012. A majority of households in the top (71%) and the bottom (69%) quintiles of the income distribution experienced no movement across the quintiles between 2009 and 2012, but there was much more movement among those in the middle-income quintiles. Between 45% and 50% of households in the second, middle, and fourth quintiles were in the same quintile in 2009 and 2012. Between 2009 and 2012, 11% of U.S. households experienced changes in their annual incomes that resulted in their moving either up or down two or more quintiles in the income distribution. Approximately 10% of households that started in the top and fourth quintiles experienced a decline of two or more quintiles.[14]

A 2017 Pew Charitable Trust study based on data from Pew's Survey of American Finances found that between 2014 and 2015, 34% of families saw changes of more than 25% in their income.[15] The median household income gain was $20,500 and the median income loss was $25,000. Low-income families were more likely than others to experience large percentage changes in income (but less likely to experience large dollar changes).

There is sufficient evidence to know that one year of income data does not adequately represent household financial capacity—but that allowing Pell eligibility to continue without annual FAFSA filing would not cause a major disruption. This one-time FAFSA might, as CAP suggested, be based on multiple years of income data. And to reiterate, income fluctuations for applicants who are Pell eligible rarely result in large changes in award levels. However, further analysis of these issues using data on household incomes over time would be helpful.

> *Coordinating the auto-zero EFC and the simplified needs test with the EFC formula could reduce the burden of completing the FAFSA for many students without creating a significant reduction in aid eligibility for those who just miss qualifying for these simpler calculations.*

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[13] Susan Dynarski and Mark Wiederspan, *Revisiting FAFSA Simplification: Expanding Access to the IRS Data Retrieval Tool,* (Gerald R. Ford School of Public Policy, University of Michigan, Education Policy Initiative, 2015), http://www.edpolicy.umich.edu/files/brief-1-revisiting-fafsa.pdf.

[14] John J. Hisnanick, Katherine G. Giefer, and Abby K. Williams, *Dynamics of Economic Well-Being: Fluctuations in the U.S. Income Distribution: 2009–2012,* (United States Census Bureau, Household Economic Studies, 2017), https://www.census.gov/content/dam/Census/library/publications/2017/demo/p70-142.pdf.

[15] Pew Charitable Trusts, *How Income Volatility Interacts with American Families' Financial Security: An Examination of Gains, Losses, and Household Economic Experiences,* 2017, https://www.pewtrusts.org/-/media/assets/2017/03/incomevolatility_and_financialsecurity.pdf.

The auto-zero EFC provision makes an important contribution to simplifying the aid application process for low-income applicants. The current income threshold of $26,000 for qualifying for this process is arbitrary and there are proposals on the table that would raise that income limit. A critical issue that does not appear to garner much attention is under what circumstances families would end up with much higher EFCs if they fail to use auto-zero or just miss the cut-off. If students just miss being able to claim an auto-zero EFC, their actual EFC should be close to zero. If that is not the case, it raises the question of whether the criteria for being granted a $0 EFC are reasonable.

Under the FM formula for 2019–20, calculated EFCs for dependent students and independent students with dependents in households with one student in college are likely to be $0 at incomes significantly higher than $26,000.[16] Many variables, including family size, division of earnings between adults in the household, state of residence, and asset levels, affect the calculated EFC. Setting the threshold for auto-zero at an appropriate level requires estimating these EFCs and ensuring that the provision does not create a cliff for those who just miss out.

Modeling the EFC levels for families in different circumstances and developing a compatible method of setting the appropriate cut-off for auto-zero eligibility would strengthen the system. Similar logic applies to setting the cut-off for eligibility for the simplified needs test.

The limited definition of assets in the EFC calculation understates the differences in financial strength across families at different income levels.

The exclusion of home equity and retirement assets from the need analysis formula diminishes the measured gap in resources between low- and high-income families. Given the existence of the simplified needs test, which excludes assets for applicants with household incomes below $50,000, adding home equity into the formula would not affect most low-income applicants. Moreover, if Pell eligibility were separated from EFC calculations as numerous observers have proposed, the change would not affect Pell eligibility.

The Census Bureau reports asset holdings of households at different levels of the income distribution. In 2015, the share of households holding home equity ranged from 38% in the lowest income quintile to 84% in the highest quintile. Among those with this asset, the average amount held also increased with income and the average home equity per household is more than four times as high for high-income as for low-income families.[17]

Comparing middle- and upper-income families is perhaps more relevant for the need analysis system, given the prevalence of $0 EFCs for those at the bottom of the income distribution. 2015 home equity ownership rates rose from 64% in the middle-income quintile to 74% in the fourth quintile and 84% in the highest quintile. Average equity per household is more than twice as high at the top than in the middle of the income distribution (Table 4). These data indicate that totally ignoring home equity makes it more difficult to differentiate the financial capacities of middle- and upper-income households. These families' EFCs can make a significant difference in the amount of institutional need-based aid students receive.

[16] Based on calculations using the U.S. Department of Education's EFC formula worksheets available at https://ifap.ed.gov/sites/default/files/attachments/efcformulaguide/1920EFCFormulaGuide.pdf.

[17] Source: U.S. Census Bureau, *Wealth and Assets Ownership Data Tables,* 2019, https://www.census.gov/topics/income-poverty/wealth/data/tables.html.

Table 4: Asset Ownership by Household Income Level, 2015

	Income quintile	Lowest	Second	Third	Fourth	Highest
Home equity	Share owning	38%	54%	64%	74%	84%
	Average owned	$74,000	$79,000	$80,000	$88,000	$145,000
	Average per household	$28,416	$42,660	$51,520	$65,032	$121,945
Retirement accounts	Share owning	15%	35%	58%	72%	85%
	Average owned	$19,000	$20,000	$38,000	$60,000	$170,000
	Average per household	$2,755	$7,040	$21,926	$43,380	$144,160
Assets at financial institutions	Share owning	73%	90%	95%	98%	99%
	Average owned	$600	$1,600	$3,600	$6,800	$18,700
	Average per household	$439	$1,432	$3,413	$6,678	$18,438
Stocks & mutual fund shares	Share owning	5%	11%	16%	22%	38%
	Average owned	$15,000	$29,740	$30,000	$25,000	$55,910
	Average per household	$720	$3,212	$4,890	$5,400	$21,246

Source: U.S. Census Bureau, Wealth and Assets Ownership Data Tables, 2019, https://www.census.gov/topics/income-poverty/wealth/data/tables.html.

Differences in retirement assets are quite a bit larger than differences in home equity. The share of households holding retirement accounts rises from 15% for the lowest income quintile to 58% for the middle quintile and 85% for the highest income quintile. Average holdings are about four and a half times as high in the accounts of high-income households as in those of middle-income households, and assets per household are six and a half times as high. However, the difficulty of measuring defined benefit retirement plans makes including these assets in the formula challenging.

Information on home equity is not available from federal income tax forms. However, this is also the case for the information on financial assets currently included in the FM. Requiring families in the upper half of the income distribution to provide additional information if they want to be considered for institutional aid would not be unreasonable. However, rigorous modeling of the potential impact of such a change would allow for better decision making.

It is worth exploring the possibility of including the resources of non-custodial parents in the calculations of EFC used for purposes other than the distribution of federal need-based aid.

Another issue that would benefit from modeling efforts if the idea of developing an EFC formula based on IRS data that is separate from Pell eligibility takes hold is the role of non-custodial parents. The FAFSA asks for financial information from only one parent if a student's parents are divorced or separated and do not live together. The relevant parent is the one with whom the student lived more during the past year. If the student lived with each parent for the same amount of time, the parent who provided the most financial support is considered the custodial parent. If the custodial parent has remarried, the FM includes the financial resources of the stepparent.

If the formula relies on IRS data, the most straightforward practice would be to define the relevant parent as the one who claims the child as a dependent. However, modeling the impact of requiring information from both parents — again not for Pell eligibility — would be a constructive step. Some institutions already engage in this practice. It would be helpful to know whether considering the resources of both parents of non-Pell-eligible students would make a significant difference in the allocation of need-based aid to students in the upper half of the income distribution.

Conclusion

It is important that policymakers have reliable information about the likely impact of changes to the student aid application process. There is broad consensus that simplifying the application process and making eligibility for Pell Grants more predictable and transparent has the potential to increase educational opportunities for low- and moderate-income students.

There is strong evidence from reliable simulations indicating that moving to a simple look-up table for Pell eligibility based on a very small number of data elements available from the IRS would not have a major impact on the distribution of awards or on the total cost of the program. Tweaking the parameters embodied in the table could adjust total expenditures.

Existing research also indicates that simplifying the formula has a larger impact on EFCs for families higher up in the income distribution. Institutions and some states need an EFC formula that will allow them to equitably distribute need-based aid to students from households that are not poor.

Available evidence suggests that simplification is feasible and that data from the IRS can go a long way toward easing the application process. However, additional modeling of some potential changes to the formula could increase our understanding of which changes would add complication without making a significant difference in the ranking of families' financial capacity, and which could make important contributions to an equitable system of need-based financial aid for college students.