

Perspectives

State Student Financial Aid: Tough Choices and Trade-Offs for a New Generation

Executive Summary

Since the early 1990s, state governments have enjoyed a run of fiscal health and prosperity. As state economies have improved, budgets for social goods and services have expanded, especially in areas such as K-12 education, corrections, and health care. Higher education has also benefited from more robust state budgets, and this funding boost has helped to pave the way for the emergence of a “new generation” of state student financial aid programs.

The new generation programs are diverse both in nature and scope, as they include grants, scholarships, and tax credits/deductions, and are intended to address a number of state policy objectives. The lineage of this generation can be traced to the Georgia Helping Outstanding Pupils Educationally (HOPE) Scholarship, which was established in 1993. New generation programs share several interrelated characteristics, which include:

- **Merit/Non-Financial Need Basis**—While state student aid efforts have historically focused on those with financial need, the 1990s saw greater

emphasis on “earning” aid dollars. This shift brought greater emphasis on criteria such as grade point averages/test scores or payment of taxes and qualified higher education expenses.

- **Broad Eligibility**—Many of the recent additions to state student aid efforts reach a significant portion of potential college students via broad eligibility standards such as those cited above. Some programs are so broad that they run the risk of assuming entitlement status over the long term.
- **Political Visibility**—A growing number of state policymakers have made merit scholarships and higher education tax benefits a key element of their education platforms in recent years, with some states even referring lottery-based scholarships to public votes.
- **Appeal to Middle Class Affordability**—Public anxiety over rising student charges has risen significantly over the past decade, particularly among the middle class. Because the middle class represents such an important block of voters, politicians have

been eager to act on affordability issues for these key constituencies.

Although the full impact of these programs cannot yet be assessed due to their relatively short tenure, some lessons are already becoming apparent. This analysis examines some of the potential benefits and shortcomings of new generation aid programs, viewing available information from the Georgia HOPE Scholarship and related programs through the analytical lenses of effectiveness, equity, and efficiency.

Effectiveness

- New generation programs ease college affordability concerns for some groups, but not necessarily for those with the greatest financial need. Most of these scholarships cover full tuition costs at public colleges and universities, and eligibility standards are generally set at levels that enable significant percentages of high school graduates to earn scholarships. At the same time, however, many of these programs are not likely to improve affordability for students from the lowest income groups. Because most new generation programs

cover only tuition charges, and have provisions that subtract federal aid from state awards or provide non-refundable benefits (tax credits), qualified students that face the greatest challenges in covering the total cost of attending college benefit the least from these programs.

- Data from the Georgia HOPE program suggest that new generation scholarship programs help to improve preparation and retention, but appear to have little effect on boosting college performance. In Georgia, high school grades and SAT scores have risen since the implementation of HOPE, as has the percentage of students completing college prep diplomas. The percentage of entering students requiring learning support courses (remediation) has also decreased. However, a significant portion of students are losing their scholarship eligibility due to grades, and the difference in the average college GPA between HOPE recipients and non-recipients is quite small.
- Some new generation programs have been adopted with the intent of stanching states' perceived "brain drain," but evidence of programs' effectiveness in this area is inconclusive at best.

Equity

- Despite simple and seemingly "attainable" eligibility standards, all high school students do not enjoy the same probability for earning or retaining new generation scholarships, especially those programs with a grade threshold for eligibility (e.g. "B" average). Student academic achievement is correlated with a number of personal and family measures—such as parents' income and education level—which impact students' chances for earning these awards.
- Depending on their funding source and eligibility criteria, new generation programs have the potential to redistribute wealth from those in lower income groups to those in upper income groups. This is a matter of particular concern for programs funded by lotteries that use simple grade thresholds for eligibility. Data from Georgia show the potential for such a redistribution.

Efficiency

- Many new generation programs are inefficient in that they provide significant benefits to students who already have the means and/or ability to leverage funds to cover college expenses. The recipients of merit-based scholarships are disproportionately from middle and

upper income families; many such families can pay at least a portion of students' college expenses. Many of these same recipients are also the primary beneficiaries of other college affordability programs, such as federal tax credits/deductions, prepaid tuition plans, or college savings plans. Finally, colleges and universities often aggressively compete to enroll top academic achievers, by offering significant aid packages. New generation programs therefore often layer the benefits provided to the same set of students.

The new generation of state student aid programs aims to accomplish a number of worthwhile objectives, such as greater access to and persistence in college. Many of these programs do provide financial assistance to deserving students, demonstrate potential to boost attendance and completion, and address the concerns of a politically potent constituency, but at what price? Policymakers should avoid the temptation to oversimplify in creating this new generation of state student aid programs. In so doing, they will create programs that enjoy a broad base of support but are more efficient, more equitable, and therefore, more effective.



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Authors: Travis Reindl, AASCU Policy Analyst and Dana Brower, AASCU Policy Intern

American Association of State Colleges and Universities

1307 New York Avenue, NW • Fifth Floor • Washington, DC 20005-4701
Phone: 202.293.7070 • Fax: 202.296.5819 • www.aascu.org

Perspectives

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OVERVIEW

Government provision of financial aid to students is a relatively recent concept, as the vast majority of government aid programs have emerged in the past half-century. Despite the relatively short life of financial aid programs, the evolution of these programs—in their philosophy, character, and political visibility—has been intense. Financial aid programs have evolved from issues of political insiders’ purview to issues of primary concern among voters,¹ paralleling what has been termed the “democratization of higher education.”

The evolution of financial aid programs at the state level has been rather sporadic. However, the State Student Incentive Grant (SSIG)* program, created as a part of the 1972 reauthorization of the Higher Education Act (HEA), was successful in spurring the creation of undergraduate, need-based aid programs in the nearly 50 states that did not have them prior to its passage. Although state financial aid programs remain quite distinct in their character and provisions, the overall state commitment to student financial aid has grown. Between 1970 and 1995, the percentage of state appropriations

dedicated to student aid programs increased from 3.2 percent to a peak of 7.4 percent.²

In the 1980s, however, a subtle shift began to occur, and a number of non-need-based aid programs began to spring up. These programs—such as merit-based scholarships and tuition assistance grants—were created for a variety of reasons: providing additional incentive for students to attend college, improving college affordability during an era of rapidly rising tuition, and keeping the brightest students in state for college. Despite the quick growth and popularity of non-need-based aid programs, funding for these programs remained a relatively small percentage of total state financial aid. By 1989, non-need-based grants and scholarships constituted 11 percent of all state aid to undergraduate students.³

The 1990s brought a number of factors that impacted higher education and student aid funding. First, the recession plaguing state governments in the 1980s and early 1990s lifted, and higher education became a beneficiary of more flexible state budgets. Along with the increase in appropriations came a reinvigorated

push for accountability. In addition, states were becoming increasingly concerned about “brain drain,” so they began providing incentives for their “best and brightest” students to attend college in state. This concern was partially linked to an increasing recognition of the connection between education and state economic development. Finally, concerns regarding college affordability were mounting, as student tuition climbed from 14.6 to 18.6 percent of total revenue at public four-year institutions between 1988-89 to 1996-97, while state appropriations as a portion of total revenue declined from 39.3 to 30.9 percent.⁴ [See Figure 1]

THE “NEW GENERATION”

It was in this environment that a “new generation” of state financial aid programs emerged. Marked by the birth of Georgia’s Helping Outstanding Students Educationally (HOPE) Scholarship program in 1993, this generation of programs has advanced the shift in the award of state aid dollars from financial need to non-need criteria. Between 1989-90 and

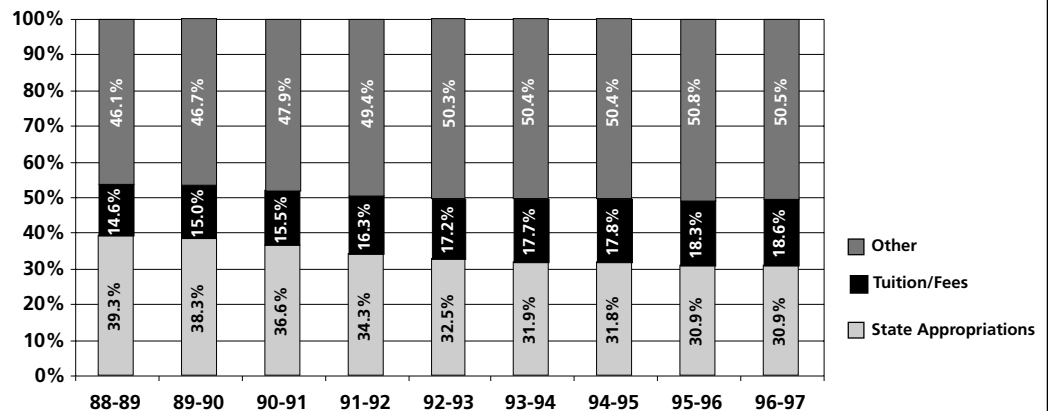
*now known as LEAP (Leveraging Educational Assistance Partnerships)

1997-98, the proportion of state aid dedicated to undergraduate, need-based programs fell from 88.8 percent to 83.3 percent, while the proportion of funds dedicated to non-need-based grants grew from 11.2 percent to 16.7 percent. [see Figure 2]

Although the shift in funding rendered by new generation programs is not seismic, and the concept of merit-based aid is not new, there are important political and philosophical undercurrents that help distinguish these programs. Most of the new generation programs share the following characteristics:

- **Broad Eligibility**—Most programs cover a significant portion of the college-going population (i.e. students with a 3.0 grade point average, taxpayers with dependent students and an annual income of less than \$100,000, etc.), such that some higher education observers view them as a form of entitlement.
- **Political Visibility**—Elected state leaders have historically included student aid programs as part of their higher education platform, but seldom have they enjoyed the attention that the new generation programs are receiving. Lottery-

Figure 1. Revenue Sources, Public Four-Year Institutions, 1988-89 to 1996-97



Source: U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS), Finance Surveys (FY89 and FY97)

based scholarships have been the subject of statewide ballots in several states, and some governors have made non-need-based aid a focal point of their higher education agendas.

- **Middle Class Appeal**—The vast majority of these programs are also focused on middle income citizens and their college-going children. This focus is both direct (tax deductions and credits that phase out at \$100,000) and indirect (scholarships for B average students, who tend to be from more affluent families).

Since the initiation of HOPE, the rise of new generation of aid programs has been rapid. Within the past two years alone, nearly half the states have considered or approved some form of merit scholarship program.⁵

Additionally, eight states took up nearly 20 bills related to higher education tax credits/deductions in 1999 alone.

New generation programs take two primary forms:

1. Merit-Based Grants and Scholarships

These programs award funds to students based on demonstrated performance, but differ from state to state in how performance is demonstrated or in how funds are allocated. Examples include:

- **Grade Point Average (GPA) Grants and Scholarships**—These programs offer awards based on the student's grade point average (GPA) in high school, college, or both. This is the basic premise of the Georgia HOPE Scholarship, and has become the model for numer-



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Authors: Travis Reindl, AASCU Policy Analyst and Dana Brower, AASCU Policy Intern

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ous other states, including Kentucky, Florida, West Virginia, and Maryland.

- GPA/Class Rank/Test Performance Grants and Scholarships**—These programs, in addition to requiring a specified grade point average in high school and/or college, stipulate that students pass or receive a specified score on a state or national examination to be eligible. Louisiana, South Carolina, Nevada, New Hampshire, and Colorado are states with this type of scholarship program.
- Test Performance Grants and Scholarships**—These programs award funds on the basis of performance on state/national examinations, and are the newest component of this movement to emerge. Michigan and Delaware have test performance grants and scholarships.
- Occupational Demand-Related Grants and Scholarships**—These programs award funds to students who demonstrate specified academic performance (either through GPA or test score) and seek degrees in areas deemed by the state to be strategically important for economic development purposes. Maryland implemented an occupational demand-related scholarship program in 1998 followed by Pennsylvania in 1999.
- Competency-Based Assessment Grants and Scholarships**—In the past several years, the concept of assessing K-12

students by mastery of core competencies (as opposed to seat time and letter grades) has gained traction in a number of states, and several states are experimenting with competency-based admissions standards for their colleges and universities. One state—Oregon—is leading the way in this area and is adapting its state student aid programs to reflect its new assessment and admissions policies.

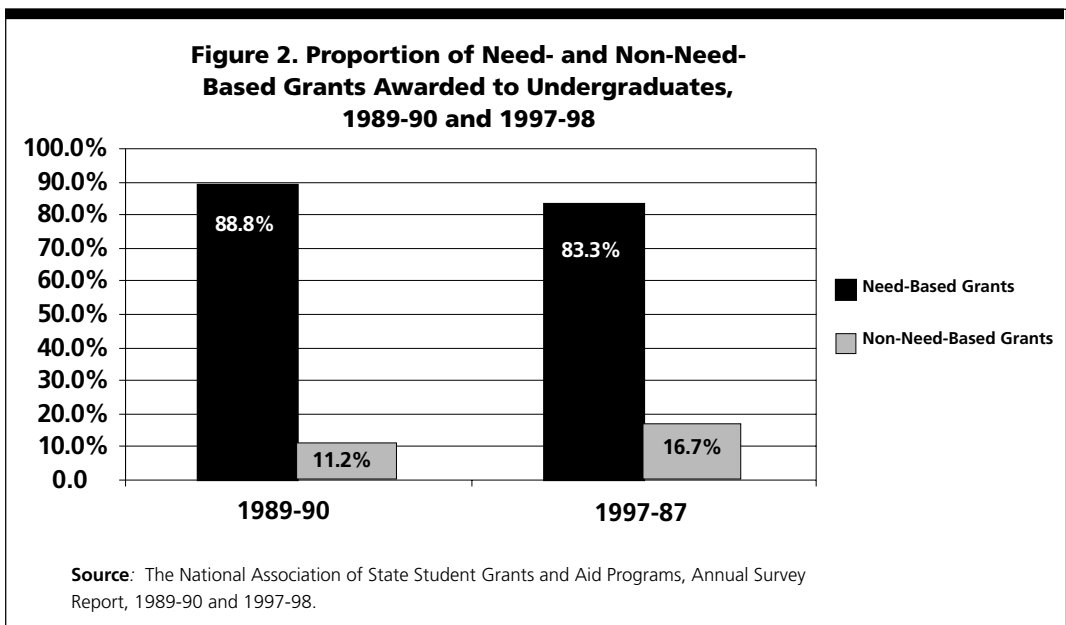
2. State Tax Credits and Deductions

The Taxpayer Relief Act of 1997, which contained the federal HOPE scholarship and Lifetime Learning Tax Credits, gave the federal tax code a substantially increased role in the provision of student financial aid. A number of states have taken their cue from this program and are considering tax incentives for students and their families. While these proposals have yet to enjoy significant legislative success, they offer a glimpse into policymakers' thinking about new forms of student financial aid at the state level.

- Tax Credits**—These programs allow the taxpayer to subtract a portion of

the amount spent on higher education-related expenses (less any grant or gift aid) from the amount they owe in state income taxes. For example, John Doe in Anystate spent \$1,500 on college-related expenses in 1998. He owes \$3,500 in state income taxes, but can subtract \$750 from that total because he is allowed to claim 50 percent of his spending on college expenses as a tax credit. States considering tax credit programs in 1999 included Connecticut, Illinois, Indiana, Minnesota, New Jersey, and Pennsylvania.

- Tax Deductions**—These programs allow the taxpayer to subtract a portion of the amount spent on higher education-related expenses (less any gift or grant aid) from their taxable income. For example, John Doe in Anystate spent \$1,500 on college-related expenses in 1998. His taxable income (for state income tax purposes) is \$35,000, but he can subtract \$1,500 from that because he is allowed to claim all of his spending on eligible college expenses as a tax deduction. Connecticut, Illinois, Indiana,



Montana, and New York considered tax deduction programs during the 1999 legislative session.

As the preceding discussion indicates, the present wave of new generation programs has some distinct typologies. However, the clear and general trend is toward providing broad benefits for potential college students based on criteria other than financial need.

ANALYSIS AND DISCUSSION

From a political standpoint, assessing the new generation of state student aid programs is a relatively simple task. Proponents of the new merit scholarships and higher education tax benefits tout the programs' inherently American philosophy of rewarding hard work. They assert that the programs encourage participation in higher education, promote better academic preparation and performance, and ease growing concerns about the affordability of a college degree. Critics of the programs, however, view them as little more than political gimmicks, or broad giveaways to the middle and upper classes that lavish benefits on the "haves" while leaving the "have-nots" no better off—or possibly worse off—than before.

From a policy standpoint, however, the view is more complex. A three-pronged framework is therefore employed to guide the following analysis, one that relies on analytical lenses of effectiveness, equity, and efficiency. The following discussion indicates that new generation programs may satisfy some important policy objectives, such as improving college preparation or easing affordability concerns for certain groups. However, they may do so at the expense of other, equally important objectives, such as providing economic access for the neediest

college students. In light of these trade-offs, policymakers in states that have approved or are considering new generation programs should carefully assess their goals and motivations, and exercise caution in their decisions. These leaders should also consider the unique higher education needs and objectives of their states, in addition to the potential benefits and consequences of various aid strategies. Higher education leaders have a role to play in the dialogue by raising key questions and ensuring that the long-term implications of aid policies, as opposed to their immediate political popularity, are given due consideration.

1. Effectiveness

Of the three evaluative criteria, effectiveness is probably the easiest to define and the most difficult to measure. It is the easiest to define in that determining program efficacy hinges on two simple questions:

- Does the program accomplish what it was intended to accomplish?
- Does it do so without unanticipated and/or undesirable consequences?

Effectiveness is the most difficult criterion to measure, however, because some program objectives are more easily measured than others and because significant data are not yet available on many of the new generation programs. Early data indicate that new generation programs are more effective in meeting some of their goals (improving academic preparation) than in others (bolstering performance and increasing affordability). Due to the limited data available on these programs, a number of observations in this area will rely on data from the Georgia HOPE Scholarship Program. The Georgia HOPE program has changed over time, which makes it difficult to conduct cross-cohort and trend

analyses from available data. However, the data are useful for highlighting trends and assessing some potential consequences of merit-based programs.

Affordability

The new generation of merit scholarship and tax incentive programs help to address the challenge of improving college affordability. These programs distribute considerable sums of money to large numbers of students, and awards generally cover a significant portion of student charges at public colleges and universities.

- In Georgia, HOPE Scholarships cover the cost of tuition and fees at any public institution, and provide recipients with a book allowance. For students opting to attend private colleges, the HOPE Scholarship provides \$3,000 to offset tuition. Between 1993 and 1998, the percentage of high school graduates eligible for HOPE increased from 46.8 to 59.5 percent.* During the 1998-99 academic year, about 27,000 Georgia college freshmen received a HOPE award. Nearly 20,000 of those students attended Georgia public colleges and universities, and more than 7,000 freshmen applied HOPE awards toward private college costs.⁶

Unfortunately, many new generation aid programs may not increase college affordability enough for those who face the greatest affordability challenges. Aid policies often render merit scholarships "last resort" funding. Therefore, students who receive need-based aid from other sources (particularly the federal government) often have that aid

*Income caps of \$66,000 and \$100,000 restricted program eligibility during the first two years.

deducted from their maximum state award.

- In Georgia, federal Pell awards offset HOPE funds. Therefore, the more Pell dollars a student receives, the less HOPE money s/he is awarded. Students who receive Pell awards that cover public college tuition and fee costs receive only a book stipend through HOPE. For the neediest students, the assistance provided through these combined programs may not be enough to enable them to enroll or persist in college.

Many of the proposals for state higher education tax credits and deductions present a similar problem. In the case of tax credits, most are made non-refundable, which means the credit may only be deducted from a family's total tax liability. Therefore, families with zero or negative tax liability (the very poorest families), receive no benefit from these programs. Conversely, those families with incomes significant to pay out-of-pocket college expenses and/or families with students attending higher priced institutions benefit the most from tax credit provisions. At the federal level, families with incomes between \$40,000 and \$90,000 have been the largest beneficiaries of the HOPE Scholarship Tax Credit program.⁷

Some attempts have been made to ensure that tax benefits do not accrue to the wealthiest families by writing income ceilings into eligibility criteria. Tax benefits proposed by Connecticut and Illinois in 1999 had adjusted gross income (AGI) ceilings of \$100,000 for joint filers, while joint AGI threshold in Minnesota's proposed law was \$80,000. Even with such caps, these programs are primarily oriented toward families above the median family income.

Preparation and Performance

The available evidence suggests that many new generation programs, particularly those similar to the Georgia HOPE program, may be more helpful in improving preparation for college than in enhancing college performance.

Preparation

One of the stated goals of many new generation programs is improving student preparation for college at the secondary level. Preliminary findings from Georgia indicate that programs may have positive effects in this area:⁸

- The percentage of Georgia high school graduates earning a core course GPA of 3.0 or above rose from 36.3 percent in 1993 to just over 50 percent in 1998.
- The percentage of high school graduates earning college prep diplomas also increased slightly, from 94 percent in 1993 to 95.5 percent in 1998.
- The average SAT score for entering freshmen at all University System of Georgia (USG) institutions rose 3.4 percent (from 975 to 1008) between 1993 and 1998. The percent change in all Georgia SAT scores during the same 5-year period was a 2 percent increase. By comparison, U.S. mean SAT scores increased only 1.4 percent, and the composite score of states comprising the Southern Regional Education Board (SREB) territory increased only 1.2 percent during this period.
- Although the percentage of all USG first-year students requiring learning support (remediation) jumped nearly 10 points between 1993 and 1994 (the income eligibility cap was raised from \$66,000 to \$100,000 in 1994 before being

dropped in 1995, and program size more than doubled as a result), the number of HOPE recipients requiring learning support has since declined, falling from 20.1 percent in 1994 to 13 percent in 1998. The percentage of all first-year students requiring learning support has declined from 32.1 percent to 19.2 percent during the same period.

Performance

Another stated goal of many new generation scholarship programs is the improvement of academic performance in college. This goal is closely linked to the public agenda, as a recent study by the National Center for Public Policy and Higher Education found consensus among business leaders, policymakers, and faculty and campus leaders regarding the need for higher academic standards in the nation's higher education system.⁹ By requiring a specified grade point average or similar benchmark for retaining awards, new generation scholarship programs aim to promote improved academic performance. Whether they will be effective in this respect remains to be seen.

- In the area of retention, HOPE recipients fare better than non-recipients. According to a 1999 Georgia Council for School Performance Report, approximately 70 percent of the 1994 through 1997 HOPE cohorts persisted in college following two years of study. Only about 40 percent of non-HOPE peers from the same entering classes were still enrolled after two years.¹⁰
- The mean GPA distinction between HOPE and non-HOPE recipients, however, is surprisingly small: less than 0.2 points between HOPE recipients non-recipients from 1994

to 1997. The class GPA of 1997 HOPE recipients was 2.50, compared with a 2.38 mean GPA for 1997 HOPE non-recipients. Over this four-year period, the class GPAs for both HOPE recipients and non-recipients remained essentially constant, with a total variance of only 0.05 points in each category.¹ [See Table 1]

Data on the retention of HOPE scholarships also suggest that the link between academic preparation in high school and college performance may be weak.

- Most Georgia students who receive a HOPE Scholarship lose the scholarship within two years of starting college. After four years of college, less than one quarter of the initial HOPE recipients from the entering classes 1995 through 1996 retained their scholarships and persisted in college. [See Table 2]

This apparent “gap” in college performance implicates a common criticism of merit-based aid programs: grade inflation.

The Grade Inflation Question

One of the criticisms leveled against the grade-based new generation programs is that emphasizing academic performance by focusing on a single grade threshold (such as a B average) will lead to grade inflation pressures for secondary instructors and college faculty. In Georgia, the data illustrate an apparent disconnect between high school grades and college performance, as evidenced above. Overall, however, the evidence is inconclusive, which does not prove inflation but does not eliminate the possibility of it, either.

- According to a report published by Georgia’s Council for School Performance, the proportion of high

school graduates eligible to receive HOPE scholarships (students with a GPA of 3.0 or above) increased from 46.8 percent in fall 1995 to 59.5 percent in fall of 1998.[†] During the same period, the SAT scores of HOPE recipients at Georgia’s public institutions also increased at every GPA quartile between a 3.0 and 4.0.¹² The Council for School Performance cites the corresponding increases as evidence to counter the grade inflation claim.

- Data from the University of Georgia, however, tell a somewhat different story. Following the initiation of HOPE, the average high school GPA of incoming freshmen at the University of Georgia increased from 3.33 in 1993 to 3.52 in 1997. During the same period, the average SAT score of University of Georgia freshmen fluctuated, increasing from 1,086 in 1993 to 1,109 in 1995, and then dropping to 1,090 in 1997. Meanwhile, the proportion of A and B grades given to University of Georgia freshmen between fall 1993 and fall 1996 rose significantly, from 50.7 to 62.7 percent.¹⁵

Advocates of grade-based scholarships argue that grade inflation is an ongoing national trend that began well before the advent of new generation scholarships. Although merit-based scholarships certainly have the potential to exacerbate grade inflation, it would be extremely difficult to determine the true extent to which they contribute to this trend. Perhaps the more important question is whether merit-based programs emphasize grade attainment at the expense of rewarding student

[†]Some of the increase can be attributed to raising and then eliminating the program’s income eligibility cap.

Table 1. Comparison of HOPE and Non-HOPE Students’ College Performance 1994-1997
(in percentages)

Entered in:	Received HOPE				Did Not Receive HOPE			
	1994	1995	1996	1997	1994	1995	1996	1997
Still in College	70.7	78.2	92.3	99.7	37.4	50.0	68.3	90.5
College GPA	2.52	2.47	2.48	2.50	2.33	2.36	2.38	2.38
College Credits	81.1	59.6	32.8	11.4	48.1	37.0	21.9	8.3

Source: Georgia Council for School Performance; *An Evaluation of Georgia’s HOPE Scholarship Program: Impact on College Attendance and Performance*, 1998.

Table 2. Percentage of HOPE Recipients Retaining Scholarships & Persisting in College
(in percentages)

Retained HOPE & Persisted . . .	1993	1994	1995	1996
After two years:	38.9	40.6	44.1	46.1
After four years:	21.7	20.7	22.7	—

Source: Georgia Council for School Performance, *An Evaluation of Georgia’s HOPE Scholarship Program: Effects of HOPE on Grade Inflation, Academic Performance and College Enrollment*, 1999.

learning, which often does not equate to a 3.0 or higher grade point average.

“Brain Drain” Prevention

In an age of increased student and employment mobility, retaining a state’s “best and brightest” has become a growing concern among policymakers. Many of the new generation aid programs address this concern by providing incentives for students to attend college in their home states. In particular, Midwestern states are seeking to slow the trickle of college graduates crossing the borders for employment. Other states, such as Pennsylvania, are offering college scholarships contingent upon in-state employment following graduation.¹⁴ So far, few data are available on the success of these programs. However, the available information suggests that the impact of these efforts may be marginal.

- Since HOPE was initiated, Georgia’s border states have enrolled fewer top Georgia high school graduates. Data from the U.S. Department of Education show that the proportion of first-time, full-time resident freshmen leaving the state decreased from 26 to 24 percent from fall 1992 to fall 1996.¹⁵ These numbers do not indicate, however, whether the students remaining were among the most academically talented.
- According to Capital Research Corporation (a Chicago-based consulting firm), the likelihood of individuals remaining in their state of origin goes down as educational attainment increases.¹⁶
- One state that has encountered the limits of the “brain drain” strategy is Virginia, where a \$3,000 scholarship for top high school graduates who remain in state is being

phased out for lack of interest. Former State Higher Education Council for Virginia Executive Director Gordon Davies addressed the limited effectiveness of the program, stating, “I don’t know that state lawmakers and college officials have a lot of control over migration.”¹⁷

2. Equity

The notion of equity as it relates to higher education opportunity is complex by definition, because there are countless ways to frame the concept of equitable higher education opportunity. This analysis, however, will be guided by the principles of horizontal and vertical equity. *Horizontal equity* refers to the similar treatment of people in similar situations. *Vertical equity* refers to the appropriate treatment of people in different circumstances.

Horizontal Equity

Proponents of merit-based scholarships argue that these programs are horizontally equitable because they are based on high school academic performance, and that all youth have the opportunity to attend high school and to excel in their studies. This assessment, however, is overly simplistic.

Research demonstrates that student academic achievement varies according to a number of personal and family variables. According to a study of college freshmen conducted by UCLA, these variables include income, race, gender, and parents’ level of education:¹⁸

- Average high school grades increase with parental income. More than one third of students whose parents had incomes exceeding \$100,000 reported earning A- or better grades in high school, compared with approximately 17

percent of students whose parents’ incomes were below \$6,000.

- More than 44 percent of students from Asian families reported earning grades in the A- to A+ range in high school, compared with 29.1 percent for whites, 27.9 percent for American Indians, 21.1 percent for Latinos, 20.2 percent for Puerto Ricans, and 15.1 percent for blacks.
- The percentage of students who reported earning high school grades of A- or above increased from 18 percent among those whose fathers had completed high school to over 40 percent among those whose fathers had some post-baccalaureate education.

In addition to these personal and family distinctions relative to academic performance, the quality of education in high schools across America is far from uniform. School resources, the level of academic rigor, grading scales, and school environments all vary profoundly, resulting in two phenomena. First, it is not equally uncomplicated to obtain a B average in any given high school; therefore, students in some high schools will be at an advantage over others in attaining a “threshold” GPA. Second, a B grade—or other approved standard for eligibility—does not have universal meaning. The work it requires is not uniform, and neither is the learning it ensures.

It therefore follows that even among students earning merit-based scholarships, there are tremendous inequities in learning and college preparation. These inequities translate into disparate probability for scholarship retention, which in turn impacts college persistence and degree completion. Data from the HOPE program appear to bear this logic out.

- In Georgia, only 20.7 percent of the 1994 HOPE cohort had retained their awards after four years.¹⁹ If HOPE recipients were at least comparably prepared for college, it seems logical that the award retention rate for this entire group would be higher.
- The disparity in HOPE retention rates among graduates from different Georgia high schools seems to further support the concept of disparate college preparation. In the fall of 1997, HOPE recipients from Vidalia High School in Vidalia, Georgia, retained HOPE scholarships at a rate of 71 percent. Vidalia was one of 16 Georgia high schools that had HOPE retention rates of 50 percent or above. In contrast, dozens of high schools had retention rates below 25 percent for the fall 1997 HOPE class; the lowest rate was 8 percent.²⁰
- HOPE data also reveal disparities in retention rates for African American students. As of the fall of 1997, only 27 percent of black freshmen maintained HOPE scholarships into their sophomore year, compared with 55 percent of white students.²¹
- In Georgia, the HOPE Scholarship covers public college tuition and fees, *not* total cost of attendance (including room and board). If HOPE-eligible students receive Pell awards, however, their state awards are reduced by the amount of Pell dollars they receive. The result is that Georgia's neediest students are ineligible to receive state funds to cover living expenses for college. Because low-income families are usually unable to provide much assistance in covering college expenses, poorer students often must work a significant number of hours a week to support their college attendance. Increased work hours are correlated with reduced persistence and degree attainment. Therefore, the structure of many new generation scholarship programs unintentionally squeezes the neediest students the most.

The notion of access is also critical to vertical equity. A college education is critical to life and employment opportunity. From an economic perspective, the value of a college degree relative to individual lifetime earnings has nearly doubled over the past 20 years.²² New generation aid programs are providing students direct support for higher education during an era in which the following trends are evident:

- The chance for college attendance varies tremendously based on income. For students from the lowest U.S. family income quartile, the chance for college attendance has fluctuated between 30 and 40 percent since the early 1990s. During this same period, the chance for college attendance among the top two family income quartiles has averaged approximately 75 percent. The disparity in college opportunity between

students from the top and bottom income quartiles has grown since the 1970s, increasing from 40.2 percent to 49.1 percent in 1997.²⁵

- The chance for baccalaureate degree attainment by age 24 for students from low-income families decreased 1 percent between 1980 and 1997. In 1997, students from families with incomes in the bottom income quartile had only a 4.8 percent chance of earning a baccalaureate degree. During the same period, the chance for baccalaureate degree attainment for students from families in the top income quartile increased by 28 percent. In 1997, students from upper-income quartile families had a 57.1 percent chance of completing a baccalaureate degree by age 24.²⁴
- From 1989-90 to 1999-2000, the average cost of college attendance (including tuition/fees and living expenses) rose from 50 percent to 61 percent of median family income for families in the lowest income quintile. Over the same period, average cost of attendance rose from 14 percent to 17 percent of median family income for families in the middle income quintile, and remained steady at 5 percent for families in the top income quintile. [See Figure 3]

As the above data indicate, there are income-related disparities in U.S. higher education opportunity and attainment. Financial aid alone cannot solve these inequalities. Because middle and upper income students have better chances of earning merit-based awards and because many programs have failed to make meaningful income distinc-

Vertical Equity

Many of the new generation programs largely ignore the concept of vertical equity, as they utilize no income caps and make no distinctions among recipients based on financial circumstances. Even among the programs that utilize income caps, such caps guarantee broad inclusion.[†] Not only are some merit-based programs vertically inequitable based on their failure to tailor benefits to groups with differing needs, but some of these programs also distribute dollars inequitably due to their interplay with other forms of aid.

[†]Maryland's HOPE Scholarship program, for example, has an income cap of \$80,000.

tions, however, some new generation programs threaten to widen the educational gap between the economic classes.

An additional criticism of merit-based programs is their potential to redistribute funds in undesirable ways.

- Merit-based programs are criticized as inequitable based on their redistribution of money from the poor to the rich. Academic performance patterns demonstrate that students from more affluent families are more likely to benefit from merit-based aid programs. To the extent that merit-based scholarship programs are funded through state revenues, lower income families could be seen as shouldering the burden for educating the children of the middle and upper classes. In states where merit-based programs are funded through a lottery—such as Georgia—critics assert that low-income individuals spend disproportionately more of their incomes on the lottery than the more affluent, thereby redistributing benefits.

Although the HOPE scholarship program does not redistribute funds from the poor to rich in all Georgia counties,²⁵ the evidence that lotteries generally target poorer, less educated individuals is in little dispute.

3. Efficiency

State funding for higher education operations and student aid programs represents a significant financial

investment. Georgia’s HOPE Scholarship Program now costs nearly \$200 million a year, and expenditures for Louisiana’s Tuition Opportunity Program for Students (TOPS) totaled \$62 million in its first year. These programs carry not only significant financial costs, but significant opportunity costs as well, due to the funds they direct away from other programs. It is therefore important that the funds designated for these programs are utilized efficiently. Three principal questions guide an analysis of efficiency:

- Do programs provide funds to those who need them most, without waste?
- Do programs work constructively and effectively with other policies and mechanisms to achieve goals?
- Do programs address vital state needs?

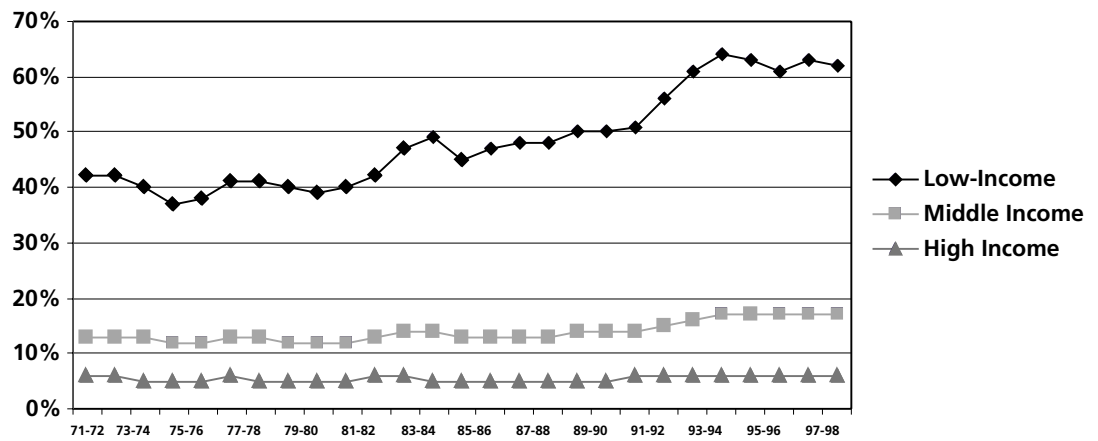
Expenditures Targeted Toward Need

A common goal of many of the merit-

based new generation programs is increased college participation. Merit-based programs presumably increase participation by providing financial incentives that make college attendance a more viable and/or attractive prospect. Due to their failure to consider financial need among recipients, however, merit-based programs are frequently criticized for giving funds to those who do not need them, or to those for whom college attendance does not hinge upon financial assistance. Data from the HOPE program seem to support this assertion.

- Only 20.7 percent of the 1994 Georgia HOPE cohort retained their scholarships and persisted in college after four years of study. However, 63.5 percent of 1994 recipients were still enrolled in college, compared to only 48.7 percent of non-HOPE recipients in the same entering class.²⁶ The higher retention rate among HOPE recipients could be attributed at least partially to better academic preparation. However, the argu-

Figure 3. Cost of Attendance at Public Four-Year Institutions, as a Share of Family Income, 1971-72 to 1997-98



Source: The College Board, *Trends in Student Aid 1999*

Note: “Low Income” refers to the lowest (first) family income quintile, “Middle Income” refers to the third family income quintile, and “High Income” refers to the highest (fifth) family income quintile.

ment could also be made that HOPE funds were not essential to college attendance for many of these students: otherwise, students who *lost* HOPE would not have outnumbered HOPE recipients (nearly 2 to 1) after four years in college.

The practice of directing funds to students based on academic merit carries opportunity costs, most significantly, the diversion of funds from qualified but financially needy students.

- Although some states rely heavily on the federal government to support low-income students, a recent study in Washington state confirmed the significance of state aid in equalizing college opportunity for low income and particularly minority students.²⁷ Recent trends in the provision of federal aid—including the shift from grants to loans and the Pell Grant’s loss in purchasing power—have, if anything, increased the significance of state aid in ensuring access and persistence for students from low-income families.

If states are genuinely concerned with increasing college participation, they should provide financial assistance to those for whom it will have the most impact on attendance. Considering need in aid distribution seems the most efficient course.

Redundant Benefits/ Interactions

Another area to be examined in gauging the efficiency of merit-based scholarships is whether programs provide overlapping or unnecessary benefits for particular groups. In today’s competitive college market, academically meritorious students already receive significant enrollment incentives from individual institutions

of higher education. Attracting the best and brightest students has increasingly become a “buyer’s market” and the institutions that make the best offer often win.

- Between 1990 and 1996, institutional grant expenditures to students rose 70 percent (adjusted for inflation). Trends for institutional aid programs mirror trends at the federal and state levels, in that increasing proportions of institutional funds are being directed toward students in middle and upper income brackets.²⁸
- In addition to institutional merit-based scholarships, there are number of other new financial aid programs from which students and their families may benefit. Two such mechanisms are tuition tax credits and college savings/prepaid tuition plans. The middle class is irrefutably the largest beneficiary of these new programs. Families with incomes between \$40,000 and \$90,000 have been the primary beneficiaries of the federal HOPE tax credit program.²⁹ According to a General Accounting Office report, a majority of families investing in tuition prepayment programs in Florida, Alabama, and Ohio (those states which had the best income data for participants) had annual incomes nearly 70 percent higher than the average income of most families with children under age 18.³⁰ Essentially, then, students from low-income families receive little benefit through these programs.

In light of the above trends and provisions, the efficiency of broad merit-based aid programs is suspect. Adding merit-based scholarships to other college affordability programs results in “layered” benefits for the same group: the middle class. These

benefits are provided in spite of the fact that some middle class families are already able to finance the costs of a public college education.

CONCLUSION

The new generation of state student aid programs does not represent the end-all and be-all of state financial aid efforts. It does represent programs that are highly popular with the middle class, and that have been largely successful in meeting some of the goals they were created to achieve. These programs have also enjoyed distinct prominence in the South, where college attendance and state funding for higher education have traditionally trailed that of other regions.

However, not all states are created equal, and neither do they have the same needs or goals that can be addressed through student financial aid. Policymakers should therefore be thoughtful when considering broad-based financial aid programs. Some specific cautions include:

- **Creating State Entitlements—** Although astutely dubbed “merit” awards, some new generation aid programs are essentially designed to benefit the average high school student; hence, their overwhelming popularity. In Georgia, approximately 60 percent of the 1998 high school graduating class was eligible for HOPE, and 70 percent of in-state freshmen entering college that fall received an award.³¹ To the extent that large merit-based programs create an expected entitlement for all students wanting to attend college, they represent a large budget line for future generations—a line that in some states is already becoming difficult to bear. At least two states with new merit-based scholarship programs—New Mexico

and Louisiana—are considering tightening eligibility requirements due to the drain on their budgets. States considering implementing merit-based programs should therefore take note, because although higher education is technically a discretionary budget item, middle class benefits are difficult to take away, once given.

- **Capturing Benefits**—Experts predicted that states would capitalize on the 1997 federal Hope Tax Credits by raising tuition. State level, merit-based aid programs provide a similar opportunity for institutions to capture benefits, either by raising tuition or eliminating (or diminishing) institutional scholarships. Since the initiation of New Mexico’s college lottery scholarship, the University of New Mexico (UNM) has begun subtracting the value of state lottery scholarships from all its institutional awards. It also eliminated all standard scholarships below the lottery award value. According to a university spokesperson, UNM is using all the scholarship money that lottery funds offset (\$2 million) for other institutional scholarships.⁵²

Just as there are cautions relative to implementing broad merit-based aid programs, there are a number of guidelines that can be offered for implementing merit-based programs in an efficient, equitable, and effective manner.

- Be aware, and mindful, regarding the interplay between the various layers of aid in the student aid equation (federal, state, and institutional). As evident by the broad disparity in the chance for college attendance by state, federal funds alone do not ensure college

opportunity for low-income students. Policymakers should therefore be careful when considering the interaction of merit-based aid with federal need-based aid.

- Note the potential interaction of a new program with other aid programs intended to ease college affordability concerns for students and their families. Without careful consideration, merit-based aid programs can result in the layering of benefits for certain groups (the middle class) that are already benefiting from other programs, such as the federal tax credits or college savings/prepaid tuition plans.
- Consider the use of income caps, which can provide a relatively easy mechanism for ensuring greater efficiency in merit-based scholarship programs. If affordability is the real issue at stake, then policymakers should carefully address the question of “affordability for whom?” If, however, a primary program goal is to increase college participation, states will more effectively achieve this goal by targeting resources to qualified students most at risk of *not* participating.
- Be aware of the myriad of other policy issues that intersect with and impact merit-based aid programs, among them affirmative action and remediation. Recent affirmative action rulings in a number of states, for example, have challenged public institutions in their quest to admit more diverse student bodies. Merit-based scholarship programs should not exacerbate this challenge. In addition, some states have passed or are considering legislation that calls for the elimination of all remedial coursework at four-year

institutions within a specified number of years. This legislation could likewise have an effect on merit-based programs. Either or both initiatives could stratify institutional enrollments in potentially undesirable ways.

The new generation of state student aid programs has an inherently political dimension. Simplicity is a touchstone of popular politics and new generation programs are likewise characterized by this quality. Eligibility criteria for these programs are simple, and program benefits are clear and universal. In creating any public policy, however, it is critical to distinguish between the notions of simple and simplistic.

Improving and rewarding academic performance among students is a simple and appropriate policy goal. It is simplistic, however, to believe that awards distributed based on academic merit will result in equitably-distributed benefits to students of different socioeconomic and racial backgrounds. It is simple to provide a uniform scholarship to all students who meet an academic threshold. Again, however, it is simplistic to assume that such an award will provide similar leverage for diverse students to attend college and successfully complete a degree. Finally, it is simple logic to understand that broad-benefiting, merit-based programs will be highly popular with middle class America. It is simplistic, however, to stop the analysis there. Middle class Americans are undoubtedly concerned about the costs of a college education, and they expect the government’s assistance in sharing responsibility for those costs. These sentiments do not imply, however, that middle and upper income families are opposed to the provision of additional (and more vertically

equitable) financial aid for low-income or previously underrepresented students, to ensure them college opportunity as well.

As the preceding analysis indicates, new generation programs have a number of worthwhile objectives and demonstrate potential on a number of counts, including: providing financial assistance to deserving students; increasing college preparation, attendance, and completion rates; and addressing the affordability concerns of a politically potent constituency. But at what price? Policymakers in the new generation of state student aid programs should avoid the temptation to oversimplify. In doing so, they can create programs that enjoy a broad base of support, but are more efficient, more equitable, and thereby more effective. ♦

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