

## College Savings Initiative

# INCREASING COLLEGE COMPLETION AMONG LOW-INCOME STUDENTS THROUGH SAVINGS

## Assessing and Expanding 529 Savings Plan Innovations through the College Access and Completion Fund

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Earlier this year, the Obama Administration released a bold new plan for improving the state of higher education in the United States. Its fiscal year 2010 budget proposal included several items aimed at increasing postsecondary education enrollment and completion rates, and decreasing the financial burden that college represents to many lower and middle class families. These proposals include reforming the federal student loan program, expanding Pell Grants for low-income students, and creating a new College Access and Completion Fund.

The CACF is a five-year, \$2.5 billion fund to support state initiatives that would help more low- and moderate-income (LMI) students both enroll in and complete postsecondary education. The overall goal of the fund is to identify the most effective strategies for increasing completion rates for LMI students. In September, the House of Representatives passed the Student Aid and Fiscal Responsibility Act of 2009 (H.R. 3221), which very closely mirrors the Obama Administration's higher education proposals.<sup>1</sup> The bill includes the CACF with slightly more funding (a total of \$3 billion over five years) and some guidelines on how the funding should be distributed. The Senate is expected to take up this issue later this fall or in early 2010.

Beyond general guidelines, much of the CACF proposal is currently undefined, which allows for a great deal of flexibility and creativity in addressing issues of college completion. This brief highlights several promising and innovative strategies involving college savings that could be incorporated into the CACF proposal. Increasing college savings for LMI students can help make them more likely to attend and graduate because it makes college more affordable. An emerging body of research is also beginning to discover important educational and behavioral benefits of saving for college. The college savings strategies discussed here revolve around enrolling more disadvantaged students into 529 College Savings Plans and encouraging and facilitating contributions from a wide range of sources – including family, friends, and private and public institutions.

<sup>1</sup> A SUMMARY OF THE STUDENT AID AND FISCAL RESPONSIBILITY ACT (SAFRA) IS AVAILABLE AT [HTTP://THOMAS.LOC.GOV/CGI-BIN/BDQUERY/Z?D111:HR03221:@@@D&SUMM2=2&](http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR03221:@@@D&SUMM2=2&).

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529 College Savings Plans were created by states over two decades ago to help their residents keep pace with the rising costs of higher education. They were added to the Internal Revenue Code (Section 529) in 1996, and were given federal tax-advantaged treatment in 2001. Virtually every state offers or runs their own plan, with a variety of investment options. Many states offer additional tax benefits as well. Today, over 11 million accounts have been opened nationwide.

However, despite this growth, there is less-than-ideal participation by LMI families, who stand to benefit the most from saving for college. They receive few or no tax benefits from contributing to college savings plans, since they typically have no or low tax liabilities, reducing their incentive to participate. Several states, however, have begun to test innovations for helping more LMI families save for college using 529s. Current innovations by states to encourage more LMI families to save in 529s include matching contributions, opening accounts at birth, enrolling participants in the workplace, and creating partnerships with public and nonprofit organizations to educate families about 529s and the importance of saving for college.<sup>2</sup> Due to limited resources though, not all states are able to test innovations and when they can, their scope is often limited. Funding from the CACF could help states surmount this financial barrier and provide a unique opportunity to test the potential of some of these strategies to impact college completion among LMI students.

## College Completion and Savings

Extensive research has demonstrated that college graduates have significantly higher incomes over their lifetimes, and receive other important non-economic benefits, compared with those who do not complete college. For poor students, a college degree is one of the best paths for climbing the economic ladder. College enrollment has steadily increased over the last several decades among all income groups, but college completion rates are problematic. Despite the strong benefits of a college degree, nearly half of students

who enroll in college do not finish. And the lower the family income of the student, the less likely they are to enroll or complete their degree.<sup>3</sup>

One of the major reasons for these low levels of degree completion, particularly for low- and moderate-income families, is college affordability. Over the past few decades, college prices have increased dramatically and need-based financial aid has not kept pace. In 1987-88 for example, the maximum Federal Pell Grant covered 50% of public higher education costs. Currently, it covers only 32%.<sup>4</sup> The result has been ever-increasing levels of loan debt for students from LMI families who do enroll. In 2007-2008, nearly 90% of LMI students who applied for federal aid graduated with student loan debt that averaged almost \$25,000.<sup>5</sup> Increasing need-based financial aid is one essential step in addressing the college affordability issue, but that alone is not enough. Additional steps also have to be taken, including making savings a larger component in helping students to pay for postsecondary education.

Research has found evidence that household savings is related to important educational outcomes such as high school graduation and college enrollment.<sup>6</sup> Current research is also exploring the potential association between savings and college completion and there have been some promising findings.<sup>7</sup> Savings provide families with resources to help pay for the cost of college, but the benefits appear to be more than just financial. There is evidence that even small amounts of savings can have positive impacts on the behaviors and expectations of both students and their parents. In terms of education, this might lead LMI families to see college as a more realistic goal and motivate students to improve their academic performance.<sup>8</sup>

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<sup>3</sup> HASKINS, HOLZER, AND LERMAN (2009).

<sup>4</sup> COLLEGE BOARD. *TRENDS IN STUDENT AID 2008* (PAGE 14, FIGURE I2B) AVAILABLE AT [HTTP://PROFESSIONALS.COLLEGEBOARD.COM/PROFDOWNLOAD/TREND5-IN-STUDENT-AID-2008.PDF](http://professionals.collegeboard.com/profdownload/trend5-in-student-aid-2008.pdf)

<sup>5</sup> KANTROWITZ (2009).

<sup>6</sup> NAM AND HUANG (2008).

<sup>7</sup> ZHAN AND SHERRADEN (2009).

<sup>8</sup> SHERRADEN (2009).

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<sup>2</sup> BOSHARA, CLANCY, SHERRADEN, AND NEWVILLE (2009).

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## State 529 Plan Innovations and the CACF

529 College Savings Plan innovations are ideally suited for implementation under the CACF for multiple reasons, such as their structure. Plans operate under a set of general federal guidelines, but are coordinated by centralized state government agencies – often the State Treasurer’s Office. As a result, states have considerable flexibility to innovate with their savings plans. Additionally, 529 plans lend themselves to data collection, which facilitates evaluation of 529 plan innovations. The CACF requires evaluation of all strategies that it funds, in order to determine which ones are the most effective at helping LMI students achieve college access and success. Best practices identified through this process can then be adopted by additional states and be used to inform federal policy.

There is also already precedent for federal matching grants being used to fund state 529 plan innovations. Through federal GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs) Programs, a handful of states have used federal matching grants to help fund 529 savings innovations for LMI students on a limited scale.<sup>9</sup>

Below is a list of a few of the innovative and promising 529 plan initiatives that states could test under the CACF to increase college completion and expand opportunity for LMI students. This list includes both existing strategies that could be expanded to more families or states as well as new innovations that could be tried for the first time. It is, however, far from exhaustive and rather represents only a strong starting point for completion-enhancing savings innovations by the states.

### *Progressive Matching*

States can encourage LMI families to open and contribute to 529 plans by matching account contributions. Research has demonstrated that matching savings at tax time can be effective at incentivizing LMI families to save for long-term goals.<sup>10</sup> Eleven states currently provide matching incentives

for 529 contributions, though they vary in terms of funding, eligibility, and match structure. Some matching programs are small in scale, and could be expanded to reach additional families with the help of the CACF. CACF funds could also be spent to allow other states to start matching programs and make this promising incentive more widely available.

### *Opening and Seeding 529 Accounts for Low- and Moderate-Income Children*

Opening and seeding accounts at birth or kindergarten would allow LMI families to begin saving early and provide them with a small initial deposit to help get them started. Currently, the state of Maine, through the Harold Alfond Challenge, provides an initial \$500 contribution to a college savings plan for every child born in the state, provided families sign up within one year of birth.<sup>11</sup> The CACF could fund pilot programs that open accounts for certain populations of LMI families. In some cases, they could also be used to open an account for every LMI child in a state.

### *Using Conditional Cash Transfers (CCTs) to Fund 529 Accounts*

States could open and contribute to 529 accounts for LMI families using conditional cash transfers (CCTs). Several US cities have begun CCT programs for low-income students, providing cash incentives for attendance, academic performance, and other benchmarks. These programs could be used in conjunction with state college savings plans, providing a combination of cash incentives and contributions to the college savings plans of students to potentially incentivize both improved academic performance and saving for college.

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<sup>11</sup> MORE INFORMATION ABOUT THE HAROLD ALFOND CHALLENGE IS AVAILABLE ON THE FINANCE AUTHORITY OF MAINE WEBSITE AT: [HTTP://WWW.FAMEMAINE.COM/NEXTGEN/MAINERESIDENTBENEFITS/HAROLDALFOND.ASP](http://www.famemaine.com/NextGen/MAINERESIDENTBENEFITS/HAROLDALFOND.ASP)

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<sup>9</sup> CLANCY AND MILLER (2009).

<sup>10</sup> DUFLO ET AL. (2005).

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### *Other Strategies to Increase Enrollment and Participation in 529s by LMI Families*

While incentives play an important role in increasing savings and participation in 529 plans, targeted outreach and new enrollment strategies could also impact college access and success. Strategies could include: using public institutions such as libraries and schools to educate LMI families about 529s and the importance of college savings; collaborating with employers to open and contribute to employee 529 plans; partnerships with community and alumni organizations to enroll students in plans; and allowing 529 plans to be opened and funded on state tax forms.

### **Evaluation of 529 Savings Innovations Under the CACF**

In addition to providing funding to states to test savings innovations like the ones described above, the CACF would also provide some funding to evaluate the effectiveness of these innovations. This provides an excellent opportunity to gain insights into some of the most pressing research questions concerning college savings and completion. Below are some of these essential research questions that the CACF could help answer:

- Are LMI students more likely to enroll in and graduate from college if they have a 529?
- How large do balances have to be to be effective at facilitating access and completion for LMI students?
- Do matching funds encourage LMI families to open and contribute to 529s? If so, which match rate is most effective?
- Does opening and seeding 529 accounts at birth or kindergarten encourage 529 participation? If so, what is the best time to open the account and seed amount?
- Which outreach and marketing strategies are most effective at increasing account opening and participation by LMI students?

- Which strategies for having employers help open and contribute to employee 529 accounts are most successful at encouraging employee participation?

### **Promising Innovation**

Research is beginning to show that savings is an important component in helping more students of all incomes access and complete postsecondary education. The creation and growth of 529 plans has made it easier for families to save, but these plans need to be improved for more low- and moderate-income families to take advantage of them. While some states have experimented with different strategies for encouraging these families to save for college, their scope is often limited. Other states have not been able to offer them due to budgetary constraints. The College Access and Completion Fund is ideally suited to help create, implement, expand, and evaluate completion-enhancing savings innovations by the states. The best practices identified through the fund could be used to inform more states as well as federal savings policy.

### **The College Savings Initiative**

The College Savings Initiative was launched in 2009 as a joint venture of the Asset Building and Education Policy Programs of the New America Foundation and the Center for Social Development (CSD) at Washington University in St. Louis. This work is supported by the Lumina Foundation for Education and the Bill & Melinda Gates Foundation.

For more information about the College Savings Initiative please go to [www.collegesavingsinitiative.org](http://www.collegesavingsinitiative.org)

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