

How Scholarships Morphed into Financial Aid

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Published online: 6 July 2010
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Before World War II, academically excellent students from families unable to afford college for them could apply for scholarships available to outstanding students, but scholarships were scarce. The federal government itself did not then make direct grants to *individual* high school students to enable them to attend college, as it does now. Thomas Jefferson would doubtless have approved of scholarships to provide educational opportunities to high-ability students to attend, maybe even federal scholarships. In the course of advocating scholarships for able youngsters at the University of Virginia, Jefferson had written, “By that part of our plan [of education in Virginia] which prescribes the selection of the youths of genius from among the classes of the poor, we hope to avail the State of those talents which nature has sown as liberally among the poor as the rich, but which perish without use, if not sought for and cultivated.”¹

It is unlikely that Jefferson would have favored financial aid to students of lesser abilities. And he probably would have been astounded by “athletic” scholarships. His proposal sought students who were *intellectually* outstanding. Athletic scholarships are not merit-based scholarships in the Jeffersonian sense of rewarding intellectual achievements and potentialities. Varsity athletes

¹Notes on Virginia, 1782, *The Jeffersonian Cyclopedia* (<http://etext.virginia.edu/jefferson/quotations/foley/>), Electronic Text Center, University of Virginia Library.

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who receive scholarships are merely expected to improve the competitive performance of intercollegiate sports teams. Yet athletic scholarships do not break completely with meritocratic values; athletic scholarships are awarded on the basis of previous personal *achievements* in football, basketball, soccer, or other high school sports, and these achievements require diligent effort as well as native ability. Faculty and students always knew that athletic scholarships existed, but athletic scholarships appeared to be minor deviations from general practice; and some elite universities such as Harvard, Yale, and Princeton didn't have them at all. In short, winning a *scholarship* meant substantial previous *academic* achievement to most people.

The Shift from Scholarships Based on Academic Achievement to Federal Financial Aid

The federal government initiated the shift from “scholarships” to “financial aid” during World War II. On June 22, 1944, President Franklin D. Roosevelt signed The Servicemen’s Readjustment Act of 1944—commonly known as the G.I. Bill of Rights—one provision of which gave veterans financial resources to attend college. This provision was an expression of public gratitude, not a congressional attempt to change the basis for admitting students to college. Although the bill as a whole was controversial, the educational benefits were not; World War II was ongoing both in Europe and in the Pacific, with the outcome still uncertain. Meanwhile American troops were dying in combat—ultimately more than 400,000 died, and many more were wounded.² Providing educational opportunities for servicemen and women who served and survived seemed only right.

However, few officials anticipated how many veterans would take advantage of these educational benefits. By the time the original G.I. Bill ended on July 25, 1956, 7.8 million of the sixteen million World War II veterans participated in an education or training program.³ In the peak year of 1947, veterans accounted for 49 percent of college admissions.⁴ The

²Congressional Research Service, *American War and Military Operations Casualties: Lists and Statistics*, updated June 29, 2007, http://www.fas.org/press/_docs/RL32492.pdf.

³U.S. Department of Veterans Affairs (www.va.gov), “Born of Controversy: The GI Bill of Rights,” http://www.gibill.va.gov/GI_Bill_Info/history.htm.

⁴Ibid.

president of Harvard, James Conant, and the president of the University of Chicago, Robert Hutchins, worried about the educational consequences of admitting large numbers of students based on military service to the country rather than on substantial academic criteria.⁵ Their fears proved groundless. Reports from colleges suggested that World War II veterans tended to be more serious students than students admitted directly from high school and actually improved the educational atmosphere of the colleges they attended. Since colleges could not expand facilities and staff quickly enough to accommodate all of the veterans who wished to enroll after demobilization, colleges probably selected the academically best qualified veterans, at least at first. Nevertheless, a precedent was set for nonacademic criteria for financing attendance at college. The transformation of “scholarships” into “financial aid” had begun.

Once aid was no longer moored to academic excellence, as with traditional scholarships, financial need was an obvious first criterion to use. Most traditional scholarships also require financial need for monetary awards. But scholarships awarded to academically excellent students who are needy differ from scholarships to needy students, whatever their academic accomplishments or deficiencies. Mediocre students have an incentive to apply in greater numbers to unselective colleges because they do not perceive either academic or financial obstacles. However, uncontingent financial aid is not an incentive to *prepare* in high school by studying and doing homework. Of course, those students who want to attend selective colleges like Princeton or Brown have an incentive to prepare academically in order to have a chance for admission. For them, financial aid, though sometimes necessary, is not their *major* incentive. In any case, unselective colleges far outnumber selective ones.

Participating in community service became another basis for awarding student financial aid. For instance, President Clinton gave a speech in 1993 to an enthusiastic New Jersey audience, including nine thousand students, in which he returned to the theme of “investment” in education, a theme he had sounded when he ran for president in 1992. In return for tuition loans to make college attendance more affordable, “we’ll ask you to...help control pollution and recycle waste, to paint darkened buildings and clean up neighborhoods, to work with senior citizens and combat homelessness and

⁵Keith Olson, *The G.I. Bill, The Veterans, and The Colleges* (Lexington, KY: University Press of Kentucky, 1974).

help children in trouble.” The audience cheered. Students at the University of New Orleans also cheered later that year when he offered a more specific version of a national service plan.⁶ The national service plan turned out to be a relatively small program: only 25,000 community service jobs in 1994, rising to 150,000 in 1997. Nonetheless, President Clinton, a former Rhodes Scholar, was proposing a basis for college attendance that ignored academic criteria.

Testimonials to the personal and economic obstacles that the student overcame, cited by applicants themselves or by letters of recommendation, constitute still another basis for awarding financial aid.⁷ One way of looking at these testimonials is as a measure of “effort.” Instead of assessing achievements directly, the admissions officer assesses how hard the student has tried.

Traditional scholarship programs did not disappear. For example, the National Merit Scholarship Program, begun in 1955, awards each year about 8,200 scholarships of \$2,500 each to finalists based on their test scores on the Preliminary SAT/National Merit Scholarship Qualifying Test and other purely academic criteria in the fifty states; the National Achievement Scholarship Program, begun in 1964, awards each year about eight hundred scholarships of \$2,500 each to *African American* finalists based on their test scores on the Preliminary SAT/National Merit Scholarship Qualifying Test and other purely academic criteria to “honor academically promising high school students who are black Americans and to encourage them to pursue higher education.” Since African American students can compete for National Merit Scholarships as well as National Achievement Scholarships, black students are not limited to the eight hundred scholarship slots reserved for high-achieving black students. Nevertheless, the National Achievement Scholarship Program guarantees that a substantial number of African Americans receive Merit Scholarships in the National Achievement Scholarship Program where the scores of black students are compared with the scores of other black students in their state.

In the science field the prestigious Intel Science Talent Search rewards scientific achievement in high school students handsomely. In 2007, 1,705 students from 487 schools in forty-four states entered the Intel Science Talent Search; their research usually began years earlier. Each of the 300 students

⁶“President Clinton Unveils His National Service Program,” *All Things Considered*, Archives of National Public Radio, April 30, 1993.

⁷Clyde Haberman, “20 Triumphant Spirits Win *New York Times* Scholarships,” *New York Times*, March 8, 2003, <http://www.nytimes.com/2003/03/08/nyregion/20-triumphant-spirits-earn-times-scholarships.html>.

named a semifinalist in the Intel Science Talent Search received a \$1,000 award for his or her outstanding science research. The top prize is a \$100,000 four-year scholarship. The second-place finalist receives a \$75,000 scholarship, and the third-prize winner gets a \$50,000 scholarship. Fourth- through sixth-place finalists each receive a \$25,000 scholarship; seventh- through tenth-prize winners each receive a \$20,000 scholarship.⁸

Despite the continued prominence of traditional scholarship programs like the National Merit Scholarship Program and the Intel Science Talent Search, such traditional merit-based programs have been dwarfed by financial aid programs, eligibility for which does not include academic excellence. U.S. Department of Education financial aid programs, both grants and loans, generally subsidize good students and bad students alike in an effort to promote greater access to college. Money given for merit-based scholarships in 2004 was \$7.3 billion compared with \$39.1 billion granted for need-based “financial aid.”⁹

Why Colleges Need Financial Aid Offices: Processing Grants and Loans

Federal financial aid to students is a mixture of two kinds of subsidies: grants and loans. Consider grants first. They are gifts from American taxpayers that students do not have to repay. In 1972 Congress established Basic Educational Opportunity Grants, later renamed Pell Grants, which awarded money to college students who demonstrated financial need.¹⁰ The Pell program started modestly. In 1973–1974 Pell Grants expended about \$236,000,000 (in inflation-adjusted dollars) to subsidize 176,000 students; the minimum award in constant dollars to a student recipient was \$248, the maximum was \$2,244.¹¹ By 2007–2008 the Pell Grant program expended

⁸Joseph Berger, “Intel Competition Is Where Science Rules and Research Is the Key,” *New York Times*, March 7, 2007, <http://www.nytimes.com/2007/03/07/nyregion/07education.html>.

⁹Allan Finder, “Aid Lets Small Colleges Ask, ‘Why Pay Ivy Retail?’” *New York Times*, January 1, 2006, <http://www.nytimes.com/2006/01/01/education/01merit.html>.

¹⁰Thomas R. Wolanin, *Reauthorizing the Higher Education Act: Issues and Options* (Washington, DC: Institute for Higher Education Policy, 2003), chap. 3; Michael S. McPherson and Morton O. Schapiro, *The Student Aid Game: Meeting Need and Rewarding Talent in American Higher Education* (Princeton, NJ: Princeton University Press, 1998).

¹¹The College Board, *Trends in Student Aid 2009* (Washington, DC: College Entrance Examination Board, 2008), table 8 (prepared October 2009), “Federal Pell Grant Awards in Current and Constant (2008) Dollars, 1973–74 to 2009–10,” http://www.trends-collegeboard.com/student_aid/3_2_pell_grants_a.html?expandable=0.

\$15,498,000,000 to subsidize 5,543,000 students.¹² The low-income college students received Pell Grants in 2007–2008 averaging \$2,796 each, at a cost to taxpayers of more than \$15 billion, but 600,000 more applicants asked for grants the following year, requiring an additional \$3 billion. The politically popular idea of helping *needy* students get the chance to go to college produced other grant programs that supplement Pell Grants for various categories of students: the Federal Supplemental Educational Opportunity Grant (FSEOG) program for undergraduates who are especially needy, the cost of which was \$772 million in 2007; the Academic Competitiveness Grant program for first-year college students who have completed a rigorous secondary school program of study; the National Science & Mathematics Access to Retain Talent Grant (National SMART Grant) Program for students whose college major is physical, life, or computer science, engineering, mathematics, technology, or a critical foreign language, and have at least a cumulative 3.0 grade point average on a 4.0 scale; the Federal Work-Study (FWS) program that provides part-time jobs for undergraduate and graduate students helping professors and college staff, which cost the Department of Education \$985 million in 2007; and the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program to students who intend to teach in a public or private elementary or secondary school that serves students from low-income families.¹³ Congress delegated the task of determining which of millions of student applicants to these various programs of the Department of Education have low enough incomes to justify grants. This is not a simple task.

The Department of Education assigned part of the task of screening students eligible for federal aid to the colleges in which students planned to enroll or were enrolled—and all of the task of counseling them. However, the Department did not want 3,700 different criteria for federal student grants depending on which of the 3,700 colleges a student was in. So the Department developed a form that students in every institution must fill out *every* year: The Free Application for Federal Student Aid (FAFSA). The Commission on Higher Education set up by Secretary of Education Spellings

¹²Ibid., figure 12a, “Total Pell Expenditures (in Millions), Maximum Pell Grant and Average Pell Grant in Constant (2008) Dollars, and Number of Recipients (in Thousands), 1976–77 to 2008–09,” 14, www.trends-collegeboard.com/student_aid/3_2_pell_grants.html?expandable=0.html?CollapsiblePanel5#table8.

¹³U.S. Department of Education, *The Budget for Fiscal Year 2009*, “Office of Federal Student Aid, Federal Funds,” “Student Financial Assistance,” 356, <http://www.whitehouse.gov/omb/budget/fy2009/pdf/appendix/edu.pdf>.

described the FAFSA form as “longer and more complicated than the federal tax return.”¹⁴ Once students and their parents fill it out, students must mail it to a federal processing center where an experienced staff person evaluates it according to uniform standards. Then it is sent back to the college attended—or to be attended—by the student, indicating the extent of parental financial responsibility, how much the student is expected to earn during the summer, and how much the student is eligible for in grants and loans. The college is entrusted with the task of verifying the information that the student submitted on the FAFSA form by means of documents, such as the income tax returns of parents, and placing copies of these documents in its files. Some of the information that the student must obtain to fill out the FAFSA form for 2008–2009, taken from the official worksheet of the Department of Education, are:

- Your Social Security Number and your parents’ Social Security Numbers if you are providing parent information;
- Your driver’s license number if you have one;
- Your Alien Registration Number if you are not a U. S. citizen;
- 2008 federal tax information or tax returns (including IRS W-2 information) for yourself (and spouse if you are married) and for your parents if you are providing parent information. If you have not yet filed a 2008 income tax return, you can still submit your FAFSA but you must provide income and tax information;
- Records of untaxed income, such as Social Security benefits, welfare benefits (e.g., TANF), and veterans benefits, for yourself, and your parents if you are providing parent information; and
- Information on savings, investments, and business and farm assets for yourself, and your parents if you are providing parent information.¹⁵

The second form of federal aid is *loans*. Most federal financial aid—over 70 percent in 2007–2008—consists of *loans* rather than grants.¹⁶ Unlike Pell Grants, federal student loans are expected to be repaid with interest. Congress considered the total financial aid needed by college students too

¹⁴U.S. Department of Education, *A Test of Leadership: Charting the Future of U.S. Higher Education, A Report of the Commission Appointed by Secretary of Education Margaret Spellings*, Washington, DC, 2006, 18, <http://www.ed.gov/about/bdscomm/list/hiedfuture/index.html>.

¹⁵Free Application for Federal Student Aid, <http://www.fafsa.ed.gov/>.

¹⁶Sandy Baum and Kathleen Payea, The College Board, *Trends in Student Aid 2008* (Washington, DC: The College Board, 2008), <http://professionals.collegeboard.com/profdownload/trends-in-student-aid-2008.pdf>.

expensive to justify as gifts; hence subsidized loans of various kinds were authorized to make up the shortfall. The FAFSA form must be filled out by students to determine their eligibility for federally subsidized loans as well as their eligibility for grants. The only collateral for student loans is the prospect of the student's future earnings from employment after college, presumably out of the higher earnings students receive after graduating from college with skills enhanced by their education—unless parents are cosigners. Consequently, student loans are inherently riskier than mortgage loans because, in the event that students do not repay them, there is nothing to foreclose on. In order to make it possible for students to obtain loans, Congress subsidized Federal Family Education Loan Program (FFEL) loans made by banks, credit unions, and other financial institutions like Sallie Mae, a hybrid private-public company specializing in student loans. Later Congress also established Direct Loans to students made by the Department of Education through the financial aid offices of the colleges where the students were enrolled. All of these loans carry lower interest rates than personal loans that student borrowers can obtain from banks. For FFEL loans from financial institutions, the financial aid office refers the student to Sallie Mae or to another suggested loan organization, and that organization makes the loan, although the Department of Education guarantees its repayment. For Direct Loans, the financial aid office transmits the student's application for a loan directly to the Department of Education, which makes the loan. In addition, the Department of Education pays the interest on loans to low-income students while they are in college and for 270 days thereafter on both Direct and FFEL loans; the Department also reimburses financial institutions for 97 percent of the principal of the loans made to students if students default—as well as the accrued interest.

As with grants, different loan programs exist and were established to do a variety of things for a variety of reasons: the Federal Perkins Loan program, a low-interest (5 percent) loan for both undergraduate and graduate students with exceptional financial need, made through a college's financial aid office with Department of Education money; the Federal Family Education Loan Program (FFEL); the William D. Ford Federal Direct Loan Program; and PLUS Loans (Parent Loans). All of these loan programs place limits on the amount that students can borrow under their auspices.

What happens when students need more money for college expenses than they can obtain from these federal loan programs? They can take jobs, and

many do. They can try to get private loans from banks—not federally guaranteed subsidized loans—carrying higher interest rates because they are riskier. Students take out these private loans (if they can persuade a financial institution to make them, sometimes with the help of their parents as cosigners), usually when they reach the maximum levels of loan eligibility for various programs of federally guaranteed loans and still need money for tuition and other college expenses. Students also use credit cards as high-cost loans. In 2004 the average graduating senior not only had a diploma and payments due on federally guaranteed loans but also credit card debt of \$2,864.¹⁷ It is surely higher today. If their parents are willing to help them, parents can obtain loans, including home equity loans and, depending on their credit ratings, PLUS Loans from the Department of Education. PLUS Loans are limited yearly to the cost of attendance minus any other financial aid received by the student.

These details about grants and loans are the reality underlying the seemingly simple idea of providing government money so that needy students can afford college. Federally subsidized student loans enable many students to obtain loans to pay college costs who might otherwise not obtain them, but choosing the right loan from the available options is perplexing, as are other financial planning decisions faced by undergraduates whose parents cannot simply write checks to cover all college expenses. Consequently, virtually all colleges whose students apply for federal financial aid establish financial aid offices to guide students through the labyrinth of financial aid—as well as making realistic plans for loan repayment. Offices of financial aid need not discuss with students their academic performance. Aside from a few relatively small grant programs, federal financial aid—grants and loans—does not depend on academic performance in high school or college except for the flabby requirement of making “satisfactory academic progress.” Making “satisfactory progress” means only that (1) students must maintain a C average or better and (2) they must demonstrate progress toward graduation—in a four-year program taking no more than six years. Congress was concerned in the enabling legislation that federal financial aid should be given to needy students so as

¹⁷Nellie Mae, “Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends,” study by Nellie Mae, a Sallie Mae student loan company, May 2005, http://www.nelliemae.com/library/research_12.html.

to make higher education accessible for them, but Congress did not address seriously the subject of assessing the ability of students to do college-level work.¹⁸

Even more objectionable from the viewpoint of encouraging academic excellence are those financial aid programs that have reversed the basic idea behind traditional scholarships and target financial aid to students whose past academic records have been deficient. Academic deficiency was renamed “educational disadvantage” so that financial aid could be given to underprepared students without stigmatizing them.

Unintended Consequences: Diplomas to Nowhere and Defaulted Loans

Loans have worse unintended consequences than grants because of their repayment obligation. Even for students who graduate from college with good enough résumés to qualify for well-paying jobs, loans are burdensome at a time of life when they want to marry, have children, and buy homes. More important than the size of the loans is the ability of graduates to obtain jobs with which to pay them off. For students whose college educations did not prepare them well for the job market, the burden of college loans is

¹⁸“Satisfactory progress” was defined in Section 484(c) of the Higher Education Act of 1965 as follows:

(c) SATISFACTORY PROGRESS—

- (1) For the purpose of subsection (a) (2), a student is maintaining satisfactory progress if—
- (A) the institution at which the student is in attendance, reviews the progress of the student at the end of each academic year, or its equivalent, as determined by the institution, and
 - (B) the student has a cumulative C average, or its equivalent or academic standing consistent with the requirements for graduation, as determined by the institution, at the end of the second such academic year.
 - (C) Whenever a student fails to meet the eligibility requirements of subsection (a)(2) as a result of the application of this subsection and subsequent to that failure the student has academic standing consistent with the requirements for graduation, as determined by the institution, for any grading period, the student may, subject to this subsection, again be eligible under subsection (a)(2) for a grant, loan, or work assistance under this title.

Any institution of higher education at which the student is in attendance may waive the provisions of paragraph (1) or paragraph (2) of this subsection for undue hardship based on—

- (A) the death of a relative of the student,
- (B) the personal injury or illness of the student, or
- (C) special circumstances as determined by the institution

Congress apparently provided considerable leeway for marginal academic performance.

heavier than for students who studied engineering or pharmacy as undergraduates and obtained well-paying positions immediately after graduating. Some graduates find that they cannot keep up the payments they promised to make. They may be compelled to “default,” sometimes temporarily, sometimes permanently. Defaulting on student loans means, according to the part of a website on student loans dealing with defaults:

- Your loans may be turned over to a collection agency.
- You’ll be liable for the costs associated with collecting your loan, including court costs and attorney fees.
- You can be sued for the entire amount of your loan.
- Your wages may be garnished. (Federal law limits the amount that may be garnished to 15 percent of the borrower’s take-home pay.)
- Your federal and state income tax refunds may be intercepted.
- The federal government may withhold part of your Social Security benefit payments. The U. S. Supreme Court upheld the government’s ability to collect defaulted student loans in this manner without a statute of limitations in *Lockhart v U.S.* (04-881, December 2005).
- Your defaulted loans will appear on your credit record, making it difficult for you to obtain an auto loan, mortgage, or even credit cards. A bad credit record can also harm your ability to find a job.
- You won’t receive any more federal financial aid until you repay the loan in full or make arrangements to repay what you already owe and make at least six consecutive, on-time, monthly payments. (You will also be ineligible for assistance under most federal benefit programs.)
- You’ll be ineligible for deferments.
- Subsidized interest benefits will be denied.
- You may not be able to renew a professional license you hold.
- And of course, you will still owe the full amount of your loan.¹⁹

If one of the main goals of attending college is to help youngsters from low-income families to achieve middle-class status, defaulting on student loans defeats that goal, at least for the time being. The absence of strong academic requirements for federal student loans enables *underprepared*—albeit economically disadvantaged—students to gain

¹⁹FinAid, The Smart Student Guide to Financial Aid (www.finaid.org), “Defaulting on Student Loans,” <http://www.finaid.org/loans/default.phtml>.

access to college, not to lay the foundation for responsible post-college careers. Carried away by the desire to increase higher educational *access* for young people, especially from low-income families, successive congresses and successive presidents authorized grants and subsidized loans for college guaranteed by the Department of Education. They ignored the possibility that some students were bad risks. When students defaulted, the taxpayer became responsible for what were *subprime student loans*—somewhat analogous to subprime mortgages that caused so much trouble to the financial system.

The Department of Education does not utilize available information on the basis of which fairly good predictions are possible about prospects for loan repayment: good high school academic records, high scores on tests of academic aptitude like the SAT or ACT tests, a good credit card repayment history, and, later, college grades. The default rate on *private* student loans is half the default rate on *federally* guaranteed student loans; private lenders use assessments of the likelihood of repayment that the Department of Education ignores.

Exacerbating the default problem are college graduates from earlier years who had obtained jobs and had been repaying their loans but were let go when the sub-prime mortgage crisis hit. The national unemployment rate rose in September 2009 to 9.8 percent, the highest in a quarter century. Inevitably more defaults will materialize the longer the recession continues and the poorer the job prospects for college graduates. Such defaults will swell the federal deficit.

If student loans were contingent on the student's prospects for repaying them, fewer years at college would be wasted by underprepared students unable to repay their loans and fewer loans would be defaulted on. Guaranteed loans that are defaulted on require a taxpayer bailout. With trillions of dollars of questionable loans of all sorts sloshing around the economy, \$750 billion of existing federally-sponsored student loans—the current estimated total of those loans, not including private loans and credit card debt—may sound picayune. Yet with every passing year additional student loans are accumulating—and growing more risky. As the late Senator Everett Dirksen is supposed to have said, “A billion here and a billion there, and pretty soon you're talking real money.” Yes, defaulted subprime student loans cost real money already, and those costs are escalating. A change to

merit-based loans to students more likely to repay them would require a changed direction for federal investment in higher education. Such a change would not only offer better prospects for loan repayment to taxpayers but also less destructive consequences for underprepared borrowers. Worth a try?