

**An Arkansas
Higher Education
Trust Fund:
Making College
Possible for Every
Arkansan**



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Building communities. Changing lives.



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Executive Summary

The new economy or knowledge-based economy has changed the resources that are driving national and state economic prosperity. Resources such as timber, farmland, waterways and transportation routes, although still important, are being surpassed by other critical resources.

A college-educated workforce is arguably the most critical new resource. Increasingly, jobs that require college credentials are the jobs of the future. A better-educated workforce helps attract the new, better-paying jobs of the new economy, plus helps existing businesses grow and remain competitive.



Very simply, Arkansas' economic future, like every state's, is largely dependent upon the number of college graduates that stay in state to work. This is the higher education attainment imperative facing every state and the nation.

Arkansas has a unique opportunity to meet the higher education imperative—the natural gas production from the Fayetteville Shale. A modest increase in the severance tax on natural gas to a rate similar to those of surrounding states could generate billions of dollars in state revenues that could be dedicated to efforts to produce more college graduates in Arkansas. Arkansas' severance tax rate on natural gas is the lowest among the 50 states. The rate was last adjusted almost a half-century ago, spanning the administrations of 10 Presidents and nine Arkansas Governors.

Raising the severance tax on natural gas would not only be smart but fair state economic development policy. Under existing state policy, only a select group of individuals and businesses stand to benefit from the Fayetteville Shale production. Fairer state policy would ensure that all Arkansans benefit.

A primary recommendation of this report is to use the revenues from a modest increase in the natural gas severance tax to create an Arkansas Higher Education Trust Fund. A new report by Arkansas Advocates for Children and Families estimates that \$4.5 billion to \$7.5 billion could be generated by such a tax over 30 years. If put into a permanent state trust fund these revenues could generate an estimated \$200 million to \$400 million in interest revenues every year indefinitely, which could be used to fund a variety of strategies aimed at enabling more Arkansans to earn a college degree.

This report further recommends that expanding access to need-based financial aid be a key priority for the Arkansas Higher Education Trust Fund. National, state, and institutional trends in funding financial aid have been moving away from need-based aid. This report outlines several specific proposals for expanding state need-based financial aid. One proposal, the Aspiring Scholars Grant Program, expands the opportunity to attend college to every newborn Arkansan.

However, recognizing that access to financial aid, although a critical factor, is not the only factor affecting the number of students who complete college in Arkansas, the Arkansas Higher Education Trust Fund should be used to meet other higher education needs. Many colleges now do not have the institutional capacity to serve well all the students who are currently enrolled. Significantly increasing the number of students served without funding to enhance the institutional capacity to serve these additional students would be counterproductive. At the same time, institutional capacity building funding increases should be tied to increased performance accountability measures to ensure students are being better served.

To establish priorities and balance the various higher education needs within the state, an oversight commission should be established for the Arkansas Higher Education Trust Fund. Commission members should include gubernatorial appointees and leaders of the state university and community college systems. The California Legislature in 2005 passed the California Hope Endowment and Higher Education Land Grant for the 21st Century Act, which if signed by the Governor would have created a higher education endowment with a similar oversight commission.

An investment of the magnitude of an Arkansas Higher Education Trust Fund could come none too soon. Over the next decade, professions requiring a postsecondary degree will comprise an expanding share of total job growth. In Arkansas, projections are that jobs requiring a bachelor's degree or higher will comprise 28 percent of total job growth between 2004 and 2014. Two years ago, 23 percent of jobs required at least a bachelor's degree.

In addition to the increasing educational requirements of the knowledge economy's demand occupations, changing demographics, particularly a decline in the working age population, are compounding the need to increase the educational attainment of Arkansas' workforce. A recent Southern Regional Education Board report highlighting the aging workforce predicts that if the same proportion of students completes high school as today, the percentage of working age adults with a high school education will actually decline by four percentage points by 2020.

The forecasts for the number of college graduates are not much better. Nationally, the proportion of the workforce with a college degree is expected to grow only slightly over the coming decades. Between 1980 and 2000, the percentage of the labor force with a college degree grew from 22 percent to 30 percent. College attainment in the workforce is expected to increase to just 33.6 percent by 2020.

These trends present enormous challenges to all states, but particularly to states like Arkansas that already are behind most states in college attainment. The statistics are sobering:

- Arkansas ranks 48th out of 50 states in the percentage of adults with bachelor's degrees. Only 19 percent of adults have attained a bachelor's degree or higher.
- Arkansas ranks 50th in the disparity between bachelor's degree attainment by low and high income heads of households. Only 3 percent of heads of households from the poorest one-fifth of Arkansas households have at least four years of college, compared with 40 percent of the wealthiest one-fifth of households.
- Arkansas ranks 39th in young adult college enrollment and 46th in working-age adult college enrollment.
- Arkansas ranks 36th in associate's degree attainment and 45th in bachelor's degree completion.

Unless Arkansas can significantly increase the number of students, particularly those from lower-income households, who enroll in and complete college, it will continue to lag behind most states in meeting the higher education attainment imperative.

Although the factors affecting college enrollment and completion are complex, affordability is a key factor, particularly for a state such as Arkansas which has a relatively large low-income population. In fact, for the poorest one-fifth of Arkansans, net college costs even at a community college represent 44 percent of annual income. For this population, public-four year college costs exceed half of all income, and private four-year college costs exceed all annual income. Middle-class Arkansans fare little better; in fact, only the richest one-fifth of Arkansas families can comfortably afford college.

Unfortunately, trends of rising tuition and trends in financial aid funding suggest that affording college will become even more challenging, particularly for lower income families. Data in this report shows that college costs are rising in Arkansas, and that financial aid funding at the federal, state, and institutional level is increasingly favoring loans and merit-based aid over need-based aid.

From 2005 to 2007 the state increased funding for state financial aid programs by \$7.57 million. Of that funding, \$4.62 million, or 61 percent, was for the Governor's Distinguished Scholars program, the state's most restrictive merit-based financial aid program. The other programs that received fairly significant increases target specific fields of study, namely teaching and health care.

Of the state's 15 financial aid programs, just one, the Workforce Improvement Grants (WIG), is need-based only. Only students 24 and older are eligible under WIG.

Overall, for every \$1 that Arkansas provides in merit-based aid, it provides 70 cents in need-based aid. Most other states provide at least \$2 in need-based aid for every \$1 in merit-based aid.

The trend toward merit-based aid is also evident at the institutional level. For example, the University of Arkansas at Fayetteville last year offered \$1.28 million in institutional scholarships and grants for students based on financial need, compared with \$17.43 million in institutional aid for students based on merit.

In summary, increasing need-based financial aid is particularly key to improving college affordability in Arkansas. To meet this need, as well as several other financial aid needs identified in this report, the state should adopt the following policy recommendations which could be funded using interest revenues from the Arkansas Higher Education Trust Fund.

- **Create the Aspiring Scholars Grant Program.** This program would add both a seed grant and savings match grant to Arkansas' existing 529 college savings plan, the Gift Plan. Seed and savings match grants are ways to turn a 529 plan into a need-based financial aid program. Such incentives enable and encourage lower income families to use 529 plans as college saving tool; without such incentives, 529 plans are mainly a tool for upper income families.

Furthermore, seed and savings match grants are a highly efficient way for states to invest in need-based financial aid. Seed and savings match grants, particularly if deposited early in a beneficiary's life, can leverage the investment earnings potential of the financial markets to grow exponentially in value. No other state financial aid program offers such leverage.

Also, 529 plans in general are efficient from the perspective that they are a very flexible financial aid program that can serve a very broad range of students. Once an account is open, the only other qualification that has to be met is that money from the account has to be spent on qualified college expenses. There are no restrictions on the age, grade point average or standardized test score of the beneficiary, or when a beneficiary decides to go to college or where. Many state financial aid programs, including most of Arkansas', have such restrictions, which preclude certain groups of students from eligibility.

The Aspiring Scholars Grant Program would provide a state match to the savings deposits made on behalf of low-income Gift Plan accountholders. The savings match rate would vary by family income: 3-to-1 for families with incomes at or below 100 percent of poverty; 2-to-1 for families between 101 and 200 percent of poverty; and 1-to-1 for families with incomes of 201 percent to 300 percent of poverty. The annual savings match grant would be capped at \$300, and there would be a five-year limit on eligibility for the savings match. Therefore, the maximum savings match awarded to any accountholder would be capped at \$1,500. Families would be required to open the account before their child's 13th birthday.

When sufficient revenues from the Arkansas Higher Education Trust Fund are available a seed grant should be added to the Aspiring Scholars Grant Program. The seed grant would seed a Gift Plan account for every newborn Arkansan whose parents open an account before the newborn's first birthday. The seed grant amount would be progressive based on income: \$500 for families with incomes at or below 200 percent of poverty, \$250 for families with incomes between 201 and 300 percent of poverty, and \$50 for all other families. A seed grant has the potential to give every Arkansas child the opportunity to enroll in college.

The leveraging potential of both seed and savings match grants is depicted in the chart below. Seed and savings match grants enable \$100 a year in savings for 18 years to be leveraged into \$7,439, which assumes a very conservative 5 percent annual investment earnings return rate. This amount is more than enough to cover more than three years of tuition at a two-year college in Arkansas at current tuition rates.

Finally, this report’s analysis of Arkansas’ existing state financial aid programs exposed other groups of students who aren’t being adequately served. To address these gaps, the following policy recommendations are made:

- **Create a Need-based Young Adult Program** to target young adults who have been out of high school for more than a year but are younger than 24. The state’s two largest financial aid programs require students to enroll in college within a year of high school graduation, and the state’s only strictly need-based aid program targets adult students 24 and older.
- **Create a Need-based Concurrent Enrollment Program** to serve students who are concurrently enrolled in high school and college courses. The state currently does not have a program that provides tuition assistance to concurrently enrolled students.
- **Increase funding for the Workforce Improvement Grant Program**, which targets low-income adult students. This program is not funded adequately, especially given that the adult student population at Arkansas two-year colleges has grown more than twice as fast as the population of younger students over the last five years.

529 Account Comparison With Seed & Savings Match

Yearly Contribution	Annual Return	Account Value after 18 years
\$100 annual deposit without match	5%	\$3,194
\$100 annual deposit with 3:1 match for five years	5%	\$6,236
\$100 annual deposit with 3:1 match for five years and \$500 seed	5%	\$7,439

Introduction

Arkansas' economic future has always been tied to its natural resources. These resources include timber, natural gas, agriculture, waterways, and, historically, a low-wage workforce. Although current resources are still important, the changing economy is introducing newer, more critical resources.

One such new resource is a better-educated workforce. Such a workforce promotes innovation and competitiveness in existing industries. It also helps attract new, higher-wage, knowledge-based industries. Increasingly, an educated workforce means one with post-secondary credentials, from vocational certificates to associate's, bachelor's, and graduate degrees.

The recent discovery of significant natural gas reserves in the Fayetteville Shale is an unprecedented opportunity for Arkansas to expedite the transition from the old to the new resources. This transition can position Arkansas to thrive and prosper in the new economy. Increasing the severance tax on natural gas production to levels comparable with surrounding states could generate billions of dollars for a permanent trust fund for higher education. This trust fund could create the opportunity for many more Arkansans to attend college.

This is an economic policy that's both smart and fair. Under existing state policy, a relatively small group of individuals and businesses will truly benefit from Fayetteville Shale production. Fairer state policy would ensure that every Arkansan benefits.

This report recommends creating a permanent Arkansas Higher Education Trust Fund using increased severance tax revenue. Annual interest revenue from the fund could be used to meet various higher education needs. Chief among these needs is greater access to need-based financial aid. Several new ambitious financial aid programs are proposed, which could significantly improve the state's higher educational attainment for generations to come.

The Higher Education Attainment Imperative

Educational attainment, especially college credentials, is the new natural resource that will determine the economic future of Arkansas and the nation in the increasingly knowledge-based economy. Arkansas' economic future is largely dependent upon the number of college graduates who stay in the Natural State to work. This is the higher education attainment imperative facing every state and the nation.

A recent report by the Advisory Committee on Student Financial Assistance, which advises the U.S. Secretary of Education on student financial aid policy, put it this way:

“America’s competitive advantage in the global economy depends upon increasing rates of success in postsecondary education and increasing rates of bachelor’s degree attainment in particular. The decline in manufacturing jobs in today’s knowledge economy has resulted in an increased need for highly skilled workers, particularly those who have attained at least a bachelor’s degree.”¹

The U.S. Department of Labor’s Bureau of Labor Statistics (BLS) estimated last year that jobs requiring a bachelor’s degree and higher would comprise about 36 percent of total job growth between 2004 and 2014 (see Table 1). The BLS also found that an associate’s or bachelor’s degree is the most significant source of postsecondary education or training for six of the 10 fastest growing occupations.² Jobs requiring a bachelor’s degree or higher accounted for 24 percent of all jobs in 2004.

Table 1: U.S. employment and total job openings by three education clusters, 2004-14 (numbers in thousands)

Education cluster	Employment				Change Between 2004 and 2014		
	Number		Percent distribution		Number	Percent distribution	Percent change
	2004	2014	2004	2014			
Total	145,612	164,540	100	100	18,928	100	13
High school graduate or less	68,530	75,453	47.1	45.9	6,923	36.6	10.1
Some college	41,526	46,772	28.5	28.4	5,246	27.7	12.6
Bachelor’s degree or higher	33,556	42,315	24.4	25.7	6,759	35.7	19

NOTE: Detail may not equal total or 100 percent due to rounding.

SOURCE: “Occupational employment projections to 2014,” *Monthly Labor Review*, November 2005, U.S. Department of Labor, Bureau of Labor Statistics, page 80.

The outlook is similar in Arkansas. Projections are that jobs requiring a bachelor’s degree or higher will comprise 28 percent of total job growth between 2004 and 2014. Only 23 percent of jobs in 2004 required a bachelor’s degree or higher. Conversely, jobs requiring a high school diploma or less will comprise 43 percent of total job growth between 2004 and 2014. Two years ago, 48 percent of jobs required a high school diploma or less.³

In addition to increasing educational requirements of the knowledge economy's demand occupations, changing demographics—particularly a decline in the working age population—are compounding the need to increase the educational attainment of Arkansas' workforce.

A recent report by the Southern Regional Education Board (SREB) found that from 1992 to 2002 SREB states experienced an increase of 2 percent in the proportion of residents aged 25 to 64. At the same time, these 16 states, which include Arkansas, experienced a 0.05 percent decline in the proportion of residents aged 18 to 24. As the baby boomers and their children continue to age, the report predicts that if the same proportion of students completes high school as today, the percentage of working age adults with a high school education will actually decline by four percentage points by 2020.⁴

Meeting the dual challenges of a knowledge-based economy and changing workforce demographics will require significantly increasing the educational attainment of the working age population in Arkansas, well beyond current attainment rates being achieved today.

The forecasts for the number of college graduates are not much better. In 1980, about 22 percent of the labor force had a college degree—a figure that rose to 30 percent by 2000, but is expected to increase to just 33.6 percent by 2020.⁵

Meeting the dual challenges of a knowledge-based economy and changing workforce demographics will require significantly increasing the educational attainment of the working age population in Arkansas, well beyond current attainment rates being achieved today. States like Arkansas that are already significantly behind on many measures of educational attainment, particularly college completion, face an even more daunting challenge. Meeting this challenge will require solutions with a commensurate amount of ambition and resolve. This report proposes a few such solutions for Arkansas.

The Fayetteville Shale: A Unique Opportunity to Meet the Higher Education Attainment Imperative

The recent discovery of significant natural gas reserves in the Fayetteville Shale presents a unique opportunity to meet the higher education attainment imperative facing Arkansas. More specifically, revenues from production of the reserves could be used to expand access to higher education on a scale unprecedented in Arkansas and all but a few other states.

Potential Revenues

A new report by Arkansas Advocates for Children and Families estimates that increasing Arkansas' severance tax on natural gas could generate significant new revenues for the state.

Arkansas' severance tax on natural gas is the lowest in the nation and has not been increased since 1957. Unlike most states which levy severance taxes based on market value, Arkansas' natural gas severance tax is levied on the volume produced.

The Advocates report estimates that over the first decade of natural gas production in the Fayetteville Shale, a market-based natural gas severance tax based on levels comparable to surrounding states could generate \$2.25 billion to \$3.75 billion in potential state revenue. Over a 30-year period, the potential revenues are \$4.5 billion to \$7.5 billion, depending on the severance tax rate.⁶

Table 2 shows the revenue estimates from various severance tax levels over 10-, 20- and 30-year periods.

Table 2: Potential State Revenue from Natural Gas Production of Fayetteville Shale, 2006-2035

Years	Total projected production, Fayetteville shale (Bcf*)	Market value or sales @ \$7.50 per Mcf** Fayetteville Shale only	Potential Severance Tax Revenue at Different Rates of Market Value		
			3%	4%	5%
2006-2015	10,000	\$75 billion	\$2.25 billion	\$3 billion	\$3.75 billion
2016-2025	5,000	\$37.5 billion	\$1.125 billion	\$1.5 billion	\$1.875 billion
2026-2035	5,000	\$37.5 billion	\$1.125 billion	\$1.5 billion	\$1.875 billion
30-Year Total	20,000	\$150 billion	\$4.5 billion	\$6 billion	\$7.5 billion

Source: Arkansas Advocates for Children and Families, *The Arkansas Severance Tax: New Funding Possibilities?*, December 2006.

*Bcf=billion cubic feet of gas

**Mcf=thousand cubic feet of gas

Building a Trust Fund from New Revenues

Using the lower end of the revenue estimates, which are based on a 3 percent market-value based severance tax rate, over the first 10 years of production approximately \$200 million per year in Fayetteville Shale-related severance tax revenue could be generated. This is assuming that the 10-year revenue estimate of \$2.25 billion from a 3 percent severance tax rate is generated in roughly equal amounts annually. At a conservative annual rate of return of 5 percent, \$200 million deposited in a permanent trust fund each year could generate \$550 million in accumulated interest over the first decade.

Table 3 below shows the annual interest that could be generated by such a trust fund over three decades. If the severance tax were set at 3 percent of market value, the trust fund could generate \$50 million in annual interest in the fifth year; \$100 million in the 10th year; \$150 million in the 20th year; and \$200 million in the 30th year. A 3 percent severance tax according to the Arkansas Advocates report is a modest increase that would maintain Arkansas’ natural gas severance tax rate below that of most neighboring states. A 4 percent severance tax rate would increase the interest forecast by more than 30 percent, and a 5 percent severance tax rate would increase it by almost two-thirds.

A primary recommendation of this report is to use the revenues from an increase in Arkansas’ natural gas severance tax to create a permanent Arkansas Higher Education Trust Fund. Annual interest revenues from such a trust fund could be used to permanently support a variety of strategies to help Arkansas meet the higher education attainment imperative. More details on a proposed structure and priority uses for an Arkansas Higher Education Trust Fund are provided in the last section of this report, including some specific financial aid proposals.

Table 3: Cumulative Arkansas Higher Education Trust Fund interest earnings under three severance tax rate scenarios

Severance tax rate (% of market value)	Interest Earned in 10th year*	Interest Earned in 20th year*	Interest Earned in 30th year*
3%	\$100 million	\$150 million	\$200 million
4%	\$133.5 million	\$200.25 million	\$267 million
5%	\$166.9 million	\$250.3 million	\$333.7 million

*Assuming 5 percent annual rate of return

Similar Trust Funds in Other States

Several states have established similar trust funds, many for higher education purposes funded using revenues generated from extraction or production of the states' natural resources. Texas uses revenues from oil production to provide funding for the University of Texas system. Alaska created the Alaska Permanent Fund using revenues from oil production. Interest earnings from the Permanent Fund are distributed to every Alaskan; in 2003 every resident received an interest check for \$1,108.

Wyoming legislators proposed creating the Wyoming Investment in Children Trust Fund with \$200 million per year for five years in general revenues. Interest would be used to expand access to pre-kindergarten programs and to financial aid for high school graduates.

The California Legislature in 2005 passed the California Hope Endowment and Higher Education Land Grant for the 21st Century Act. The act, which was vetoed by Governor Arnold Schwarzenegger, would have created the California Hope Endowment with revenues generated from better management of state-owned properties. The endowment would have received an estimated \$2 billion in principal over 10 years, the interest from which would be used to fund "innovative approaches to increasing the number of Californians who achieve a college degree." The funding priorities of the endowment were to be established by an eight-member board made up of gubernatorial appointees and leadership from the state's four-year and two-year colleges.

The last section of this report recommends a similar management structure for an Arkansas Higher Education Trust Fund. The next section highlights the need for an Arkansas Higher Education Trust Fund by examining how well Arkansas currently is meeting the higher education attainment imperative—that is, how well it is producing college-educated workers.

Is Arkansas Meeting the Higher Education Attainment Imperative?

College Attainment

Arkansas has one of the nation's lowest college attainment rates. Just 18.9 percent of Arkansans aged 25 and older have bachelor's degrees, compared with the national average of 27.2 percent. Arkansas ranks 48th out of 50 states, with only Mississippi (18.7 percent) and West Virginia (16.9 percent) showing lower bachelor's degree attainment.⁷

Additionally, Arkansas has a wide disparity in college attainment between those with the highest incomes and those with the lowest. Just 3 percent of heads of households from the poorest one-fifth of Arkansas households have at least four years of college, compared with 40 percent for the wealthiest one-fifth of households. No other state shows such a large gap between rich and poor in college attainment.⁸

If Arkansas is going to successfully meet the higher education attainment imperative, it must address the significant income gap in college attainment. More precisely, it must significantly increase the number of individuals from low-income households who earn college degrees. The need-based financial aid proposals outlined in the last section of this report aim to address this income gap in college attainment.

College Enrollment

Arkansas also scores below most states on measurements of college enrollment for young and working-age adults.

The National Center for Public Policy and Higher Education's recently released *Measuring Up 2006* report indicates that among young adults ages 18 to 24 in Arkansas, 31 percent are enrolled in college. This translates into a national ranking of 39th out of 50 states. The top states have a young adult enrollment rate of 41 percent.⁹

Arkansas ranks 46th nationally in the percentage of working-age adults (25 to 49) enrolled in any type of postsecondary education. In Arkansas, the figure is 2.8 percent. The top states have an adult enrollment rate of 5.1 percent.¹⁰

College Completion

Arkansas' college completion rates also are relatively poor. In Arkansas, only 23 percent of first-time, full-time associate's degree-seeking students earn an associate's degree within three years of enrollment. This ranks Arkansas 36th among the 50 states. The national average is 29 percent.¹¹

In Arkansas, just 40 percent of first-time, full-time bachelor's degree-seeking students earn a bachelor's degree in six years, which ranks Arkansas 45th nationally. The top-scoring states have a six-year completion rate of 67 percent.¹²

In summary, Arkansas' current college enrollment and completion rates are low relative to most other states. This is a grave concern given that Arkansas ranks almost last in the number of adults who currently have associate's and bachelor's degrees. If these trends continue, Arkansas will continue to be well behind most states in meeting the higher education attainment imperative.

Affordability Affects College Attainment

Although the factors affecting college enrollment and completion are complex, affordability is a key factor, especially for low-income students.

A recent report finds that inadequate access to financial aid is a major factor in preventing large numbers of college-qualified students from earning a bachelor's degree, particularly those from low- and moderate-income families. The report—*Mortgaging Our Future: How Financial Barriers to College Undercut America's Global Competitiveness*—estimates that 1 million to 1.6 million bachelor's degrees were lost during the 1990s among college-qualified high school graduates from low- to moderate-income families. During the current decade, another 1.4 million to 2.4 million bachelor's degrees likely will be lost among students in these income groups.¹³

These estimates, moreover, are conservative, because they reflect only losses that occur among low- and moderate-income high school graduates who are college-qualified. Many more students are not college-qualified. Not surprisingly, the report concludes that financial barriers to attending college also negatively impact the number of students who become college-qualified by providing a disincentive to become academically prepared for college.

Arkansas' current college enrollment and completion rates are low relative to most other states. If these trends continue, Arkansas will continue to be well behind most states in meeting the higher education attainment imperative.

It should be noted that this disincentive is a shortcoming of most financial aid programs because they do not engage students early enough in the college planning process to make them understand that financial barriers can be overcome. One of the key financial aid proposals recommended in the last section of this report, the Aspiring Scholars Grant Program, addresses this shortcoming by enrolling students in a college savings plan at birth.

The *Mortgaging Our Future* report describes those bachelor's degrees lost because of inadequate access to financial aid as “an unmistakable signal that our nation has yet to make the full investment in student aid necessary to secure our economic future—a dire warning that we are requiring millions of students to mortgage their futures and ours as well.”

College Affordability in Arkansas

In Arkansas, college affordability is a challenge for many students and their families. For students from low-income families, college in Arkansas is simply not affordable, as Table 4 demonstrates.

Table 4: A closer look at family ability to pay in Arkansas

Income groups used to calculate 2006 family ability to pay	Average family income	Community colleges		Public 4-year colleges/Universities		Private 4-year colleges/universities	
		Net college cost*	% of income needed to pay net college cost	Net college cost	% of income needed to pay net college cost	Net college cost	% of income needed to pay net college cost
20% of the population with the lowest income	\$9,920	\$4,372	44%	\$5,216	53%	\$12,886	130%
20% of the population with lower-middle income	\$22,124	\$5,208	24%	\$6,438	29%	\$13,662	62%
20% of the population with middle income	\$36,100	\$5,926	16%	\$7,900	22%	\$14,402	40%
20% of the population with upper-middle income	\$55,866	\$6,130	11%	\$8,144	14%	\$14,757	26%
20% of the population with the highest income	\$97,005	\$6,167	6%	\$8,246	9%	\$15,158	16%
40% of the population with the lowest income	\$16,022	\$4,790	30%	\$5,827	36%	\$13,274	83%

* Net college cost equals tuition, room, and board, minus financial aid.

SOURCE: Taken from *Measuring Up 2006: The State Report Card on Higher Education, Arkansas*.

For the 20 percent of the population with the lowest income, net college costs even at a community college represent 44 percent of average annual income. For this population, public four-year college net costs exceed half of average annual income, and private four-year college net costs exceed average annual income. The next highest income population does not fare much better: community colleges and four-year public colleges cost between 24 percent and 29 percent of average annual income respectively, and four-year private colleges cost more than 60 percent. Unfortunately, only the wealthiest 20 percent of families can comfortably afford college net costs.

These statistics present a stark picture of how out of reach college is for students in Arkansas' lower-income families. Given all the financial obligations any family must fulfill—chief among them food, clothing, housing, and medical care—it is certainly not realistic to expect Arkansas' lowest-income families to devote more than 40 percent of their earnings to paying for college.

Unfortunately, trends of rising tuition, fees, and other higher education costs suggest that affording college will continue to become more challenging. The latest *Trends in College Pricing* report published by the College Board in October 2006 presents data that document how rapidly climbing costs are pricing college out of reach for more and more families every year.

The report states that the gathered data “confirm the widespread perception that college prices are rising much more rapidly than the prices of other goods and services.” The report adds that “the 35 percent jump in inflation-adjusted average tuition and fees for in-state students at public four-year colleges since 2001-02 is *the largest for any five-year period over the 30 years covered by this report.*” (Emphasis added.)¹⁴

Tables 5 and 6 indicate, both in Arkansas and nationally, that college costs are rising faster than inflation. The Consumer Price Index for all goods and services increased by 2.1 percent between September 2005 and September 2006, the first full months of the respective academic years compared in the report.¹⁵ Increases in costs for all categories of college—two-year public, four-year public, and four-year private—outpaced increases in the cost of living. The College Board report found that the levels of increase were similar when room and board are included in the cost equation.

Table 5: Average Published Tuition and Fee Costs, United States (Enrollment-Weighted)

School Type	Cost, 2006-07 academic year	Percent change from 2005-06
Two-year public	\$2,272	4.1%
Four-year public	\$5,836	6.3%
Four-year private	\$22,218	5.9%

SOURCE: The College Board, *Trends in College Pricing 2006* (Costs are based on in-state charges only).

Table 6: Average Published Tuition and Fee Costs, Arkansas (Enrollment-Weighted)

School Type	Cost, 2006-07 academic year	Percent change from 2005-06
Two-year public	\$2,112	6.6%
Four-year public	\$5,298	6.1%
Four-year private	\$13,659	4%

SOURCE: The College Board, *Trends in College Pricing 2006* (Costs are based on in-state charges only).

In Arkansas, the rates of increase were lower than the national averages for four-year public and private colleges, but higher than the national average for two-year public institutions.

Need-based Financial Aid Key to Affordability

For most students, access to financial aid determines whether college is affordable. For low to moderate income students it is particularly critical, as the affordability data above indicate.

There are two primary categories of financial aid: merit-based financial aid and need-based financial aid. Generally student eligibility for merit-based financial aid is based on various measures of academic achievement, very often a high school grade point average and ACT score. In contrast, student eligibility for need-based aid is based on various measures of ability to pay for college. Some financial aid programs have both merit and need-based eligibility criteria, such as the Arkansas Academic Challenge Scholarship program.

Both merit-based and need-based financial aid can come in the form of grants and loans. Grants typically do not have to be paid back, but loans typically do.

Need-based financial aid is particularly important to states like Arkansas that have relatively large low-income populations. Its importance is magnified by the fact that Arkansas has such a significant income gap in college attainment, as noted previously. And addressing this gap will largely determine whether Arkansas can meet the higher education attainment imperative of the new economy.

Aside from these realities, recent trends in financial aid funding at both the federal and state level make increasing access to need-based aid particularly critical for Arkansas.

Trends in Financial Aid Funding

Recent trends in financial aid funding have not been good for need-based financial aid. First, financial aid is increasingly being provided in the form of public and private loans, and less so in the form of grants, including need-based grants.

Since 1999-2000, total funding for federally supported grant programs has increased by 83 percent. Over the same period, total funding for state grant programs has increased by 70 percent. Federal funding for loans has increased by 84 percent over the same period.¹⁶

However, since 2002-03 funding for federally supported grant programs has increased by 18 percent, and funding for state grant programs has increased by 18 percent. In sharp contrast, funding for federal loan programs increased by 39 percent. Federal loans now constitute 51 percent of all financial aid to undergraduate and graduate students. Federal Pell grants, state grants, and institutional grants combined constitute only 32 percent of all financial aid.¹⁷

Compounding this trend is the fact that merit-based grants are growing faster than need-based grants. Since 1999-00 state merit-based aid has grown by 92 percent, while need-based aid grew by 52 percent.¹⁸

This trend toward merit-based aid is also evident at the higher education institution level. The University of Arkansas at Fayetteville, the state's largest four-year public university, last year offered \$1.28 million in institutional scholarships and grants for students based on financial need, compared with \$17.43 million in institutional aid for students based on merit.¹⁹

All of these trends combined have made affording college much more difficult for low-income students especially. The College Board summed up these trends this way: the "changing distribution of state and institutional aid [has] reduced the average net price for middle- and upper-income students relative to the net price for lower-income students."²⁰

Arkansas Financial Aid Programs and Funding Trends

Arkansas has 15 state financial aid programs. Only one is strictly need-based: the Workforce Improvement Grant (WIG) program for adult students. One of the best funded programs, the Academic Challenge, is both need-based and merit-based. The other programs are merit-based or target special student populations such as National Guard members, military and law officer dependents, racial/ethnic minorities, aspiring teachers, or health care professionals.

A recent report by the National Association of State Student Grant and Aid Programs (NASSGAP) indicates that in 2004-05, Arkansas's aid programs provided \$17.4 million in need-based aid, and \$10.821 million in merit-based aid programs. However, the \$14 million for the Academic Challenge program was reported as need-based aid, when in fact it is both need-based and merit-based. Academic Challenge recipients must have completed the pre-collegiate core curriculum in high school and obtained a 3.0 grade point average if attending a four-year institution or a 2.75 GPA if attending a two-year institution.

Adding the \$14 million in Academic Challenge funding to both the need- and merit-based categories of aid more accurately reflects the financial aid funding choices the state is currently making. When Academic Challenge is added to the merit-based aid category, the total funding for merit-based aid is \$24.821 million, compared with \$17.4 million for need-based aid. This means that for every \$1 the state provides in merit-based aid, it provides 70 cents in need-based aid. Most states provide at least \$2 in need-based aid for every \$1 in merit-based aid.²¹

Further proof that Arkansas is under-investing in need-based aid can be found in the recent *Measuring Up 2006* report. The report indicates that in Arkansas the state investment in need-based financial aid is just 22 percent of the amount of the federal investment. "Arkansas' investment in need-based financial aid is very low, and the state offers no low-tuition college opportunities."

Another way to analyze the trends in state financial aid funding is to look at the funding trends for all 15 state financial aid programs. Table 7 shows the last three years of funding for these programs.

From fiscal year 2005 to fiscal year 2007 the state increased funding for state financial aid programs by \$7.57 million. Of that funding, \$4.62 million, or 61 percent, was for the Governor's Distinguished Scholars program, the state's most restrictive merit-based financial aid program. The other programs that received an increase included the STAR Program (\$1 million); Teacher Opportunity Program (\$1.8 million); the Minority Master's Fellows (\$200,000); Arkansas Health Education Grants (\$616,686); Dependents of Law Enforcement Officers (\$20,000); and Dependents of POWs (\$60,000). All of these programs target select groups of students based on personal characteristics or field of study. The Workforce Improvement Grant program received a \$3.2 million transfer of funds from a discontinued need-based aid program.

In contrast, the Academic Challenge program, which is merit- and need-based, received a \$566,107 cut over the three-year period.

For every \$1 Arkansas provides in merit-based aid, it provides 70 cents in need-based aid. Most states provide at least \$2 in need-based aid for every \$1 in merit-based aid.

Table 7: State of Arkansas Financial Aid Programs

Program	Type	FY 2005	FY 2006	FY 2007
Academic Challenge Scholarships	Need & Merit	\$30,740,841	\$30,174,734	\$30,174,734
Arkansas Geographical Critical Needs	Special	\$200,000	\$200,000	\$200,000
Arkansas Health Education Grants	Special	\$3,159,861	\$3,453,794	\$3,776,547
Dependents of Law Enforcement Officers	Special	\$100,000	\$120,000	\$120,000
Dependents of POWs, MIAs, KIAs	Special	\$15,000	\$75,000	\$75,000
Emergency Secondary Education Loans (ESEL)*	Merit	\$81,717	\$81,717	\$81,717
Faculty/Admin Development Fellows Matching	Special	\$30,000	\$30,000	\$30,000
Governor's Scholars	Merit	\$4,877,508	\$9,500,000	\$9,500,000
Jr/Sr Minority Teacher Scholars	Merit	\$500,000	\$300,000	\$300,000
Minority Masters Fellows	Merit	\$80,000	\$280,000	\$280,000
National Guard Tuition Assistance	Special	\$500,000	\$500,000	\$500,000
Second Effort Scholarships	Merit	\$20,000	\$20,000	\$20,000
SREB Minority Doctoral Scholars	Special	\$200,000	\$200,000	\$200,000
State Teacher Assistance Resource (STAR) Program	Merit	\$1,500,000	\$2,000,000	\$2,500,000
Student Assistance Grants	Need	\$3,210,345	\$0	\$0
Teacher & Administrator Grants/ Teacher Opportunity Program	Special	\$179,544	\$2,000,000	\$2,000,000
Workforce Improvement Grants	Need	\$500,000	\$3,710,345	\$3,710,345
TOTAL		\$45,894,816	\$52,645,590	\$53,468,343

*The ESEL program is no longer an active program and these funds can be used for the STAR Program.

SOURCE: Arkansas Department of Higher Education

Further analysis of Arkansas' financial aid programs indicates other unmet needs. For one, younger adult students—those waiting more than a year to go to college after high school, but who are younger than 24—are ineligible for most programs, unless they fit one of the special student populations mentioned above. These special student population programs are very restrictive in terms of eligible students and are not relatively well-funded.

The state's two largest programs from a funding perspective, Academic Challenge and Governor's Distinguished Scholars, serve high school students transitioning to college within a year of completing high school. The one program targeting older students, Workforce Improvement Grants, is not funded well enough and does not serve adults younger than 24. Consequently there is a need for financial aid targeting young adults who have been out of high school for a year or more but are younger than 24.

Another student population that is inadequately served by Arkansas' existing financial aid programs is high school students concurrently enrolled in college courses. Concurrently enrolled students are not receiving state tuition support. Similar strategies aimed at getting high school students an early start on college, including the Early College High School program and Advanced Placement courses, are supported by the state. Concurrently enrolled students are also ineligible for most state financial aid programs for a variety of reasons, ranging from not having completed the high school core curriculum, not being degree-seeking, and not having graduated from high school.

In summary, Arkansas clearly needs to increase access to need-based financial aid. The state also needs to create access to financial aid for certain student populations not currently being served by existing state financial aid programs, which also should target students who can least afford college.

A Higher Education Trust Fund for Arkansas

To meet the financial aid needs identified above, the state should create an Arkansas Higher Education Trust Fund. As outlined above, the trust fund could be funded with revenues from an increase in the state severance tax on natural gas. As Table 3 indicated, in 20 to 30 years the fund could generate hundreds of millions of dollars in interest alone every year, which could be sustained indefinitely if the principal in the trust fund is never reduced.

Priorities

This report has demonstrated the critical need for increasing funding for certain kinds of financial aid, primarily need-based financial aid. Thus the foremost priority for the use of funds from an Arkansas Higher Education Trust Fund should be to increase access to financial aid, particularly need-based financial aid.

However, recognizing that access to financial aid, although a critical factor, is not the only factor affecting the number of students who complete college in Arkansas, the Arkansas Higher Education Trust Fund should be used to meet other higher education needs.

Most notably, many colleges do not currently have the institutional capacity to serve all currently enrolled students well. It would be counterproductive to significantly increase the number of students served without funding to enhance the institution's capacity to serve these additional students. Inadequate institutional capacity to serve existing students well is no doubt a factor in Arkansas' relatively low graduation rates, as cited above. Increasing the enrollment of lower-income students, who are relatively harder students to serve successfully, will further pressure this existing capacity. At the same time, institutional capacity building funding increases should be tied to increased performance accountability measures to ensure students are being better served.

Governing Board

To establish priorities and balance the various higher education needs within the state, an oversight commission for the Arkansas Higher Education Trust Fund should be established. As noted above, the California Hope Endowment was to be governed by an eight-member board that would make funding decisions for the endowment. Four board members were to be appointed by the Governor, and the other members would be

Arkansas clearly needs to increase access to need-based financial aid and create access to financial aid for certain student populations not currently being served by existing state financial aid programs, which also should target students who can least afford college.

leaders of the state university and community college systems. Arkansas should adopt a similar governing board with similar representation. This governing structure would enable key state higher education stakeholders to direct trust fund revenues to specific proposals for increasing access to need-based aid and other higher education priority needs.

Specific Financial Aid Proposals

Again, the foremost priorities for funding from the Arkansas Higher Education Trust Fund should be expanding access to financial aid—particularly need-based financial aid. Highlighted below are several specific financial aid proposals which were crafted to address the variety of existing needs in access to financial aid that existing state financial aid programs are not currently meeting.

Aspiring Scholars Grant Program

Like every state, Arkansas has a 529 college savings plan, named for the section of the Internal Revenue Service Code under which these plans are authorized. Arkansas' plan is named the Gift Plan. In 1996 Congress authorized 529 college savings plans to enable contributions to a savings account with tax-free earnings to pay for qualified college expenses. The investment earnings from these savings accounts are not subject to federal or state income taxes. In Arkansas, taxpayers can take a state income tax deduction of up to \$5,000 per tax year for contributions to Arkansas' 529 plan. Appendix A provides basic information on 529 plans.

Although 529 plans are an increasingly popular college savings strategy, they are largely a strategy for middle- and upper- income households—those with an ability to save enough to make the plans a useful college savings strategy.²² To enable lower-income households to benefit from 529 plans, some states offer an incentive in the form of a savings match grant, which matches, within limits, the contributions families are able to make on their own. This makes 529 plan participation possible and worthwhile as a savings tool for families with limited capacity to save on their own.

The documented success of matched savings accounts in the form of Individual Development Accounts (IDAs) has proven that given savings match incentives low-income individuals can and will save for the purchase of a major asset including a college education.²³

Seven states offer a savings match grant as part of their 529 plans: Louisiana, Colorado, Maine, Michigan, Minnesota, Rhode Island, and Utah. Match rates, match caps, and other features vary by state. For example, some states offer matches only in the first year of participation, and others impose an age requirement for match eligibility. A summary of the features of the seven states' savings match plans is provided in Appendix B.

One state, Maine, has gone a step further by providing a “seed” grant to open a 529 plan account for every newborn in the state of Maine. The First Step Grant provides a \$50 seed grant to families who open a 529 plan savings account in the first year of a newborn's life. Newborns from families with incomes below the median income for the state, currently \$52,500, receive an additional \$200 seed grant to cover the total \$250 required to open a 529 account under Maine's 529 plan.

Through the First Step Grant, Maine has turned its 529 plan into a universal college savings program with the potential to make college more affordable for every state resident.

Providing either or both seed and savings match grants is a way to turn a 529 plan into a need-based financial aid program. Furthermore, it is a highly efficient way for states to invest in need-based financial aid. Seed

Providing either or both seed and savings match grants is a way to turn a 529 plan into a need-based financial aid program.

and savings matches, particularly if deposited early in a beneficiary’s life, can leverage the investment earnings potential of the financial markets so that college savings can grow exponentially in value. Seed grants such as the First Step Grant, which are provided to beneficiaries in the first year of life, are the most efficient way to maximize the investment earnings potential of 529 plan savings accounts. No other state or financial aid program offers such financial market leverage. This leveraging potential is depicted in Table 9.

A 529 plan in general is also efficient because it is a very flexible financial aid program that can serve a very broad range of students. Once an account is open and match savings are made, the only other qualification that has to be met is that money from the account has to be spent on qualified college expenses. There are no restrictions on the age, GPA, or ACT score of the beneficiary, when a beneficiary decides to go to college or where.

Many state financial aid programs, including most of Arkansas’, have such restrictions, as noted above, and such restrictions preclude certain groups of students from eligibility for these programs. Adding seed and savings match grants to the Gift Plan would enable the plan to serve all the students who are not currently being served well under Arkansas’ existing financial aid programs.

Arkansas should add both seed and savings match grants to the Gift Plan, Arkansas’ 529 plan. A proposed name for the seed and savings match grants is the Aspiring Scholars Grant Program.

The following is a proposed design for the Aspiring Scholars Grant Program. Savings match grants would only be available to Arkansas residents younger than 13 whose family income is 300 percent of poverty or lower. Requiring an accountholder to be under the age of 13 maximizes the investment earnings potential of the savings match. Again, the younger the accountholder when the account is opened, the higher the investment earnings potential of the match.

The savings matches would be distributed on an annual basis, based only on an accountholder’s yearly savings and not on earnings on investments. The match rates would vary depending upon the adjusted gross income of the family of the accountholder. As shown in Table 8, families with incomes at or below 100 percent of poverty would get a 3-to-1 match. Families with incomes between 101 percent and 200 percent of poverty would get a 2-to-1 match. Families between 201 percent and 300 percent of poverty would get a 1-to-1 match.

Savings match grants would be capped at \$300 per year in the plan. There would be a five-year limit on eligibility for the savings match grant. This would cap the maximum savings match grant awarded to any single accountholder at \$1,500.

Accountholders who qualify for the 3-to-1, 2-to-1, and 1-to-1 savings match would have the minimum deposit to open an account reduced to \$25, \$50, and \$100, respectively. The current minimum deposit of \$250 is a significant barrier to participation for potential accountholders with low incomes. However, some minimum deposit is beneficial for purposes of establishing accountholder commitment to making future contributions.

Table 9 provides a comparison between the balance of an account with a 3-to-1 match and the balance of an account with no match. Both balances assume a \$100 yearly contribution by the accountholder starting at birth and an annual investment earnings return of 5 percent. The balance of the account without a match

Table 8: Family Income Eligibility Criteria

Adjusted Gross Income (family of four)*	Minimum Deposit	Match Ratio	Maximum Annual Match
\$20,000 and below	\$25	3:1	\$300
\$20,001-\$40,000	\$50	2:1	\$300
\$40,001-\$60,000	\$100	1:1	\$300

SOURCE: 2006 U.S. Department of Health and Human Services Federal Poverty Guidelines, accessed at <http://aspe.hhs.gov/poverty/06poverty.shtml>

(\$3,194) would not cover tuition at current rates for two years at a two-year college in Arkansas. In contrast, the balance of the matched account, even with a very modest \$100 annual accountholder contribution, is almost double the amount without a savings match. This amount (\$6,236) is enough to pay for more than two years of tuition and fees at current rates at a two-year college in Arkansas.

A seed grant component should be added to the Aspiring Scholars Grant Program, starting when adequate state revenues are available from the Arkansas Higher Education Trust Fund. The seed grant would be available to every newborn Arkansan for whom an account is opened before the newborn's first birthday. The seed grant amount would vary depending upon the adjusted gross income of the family of the accountholder. Families with incomes at or below 200 percent of poverty would get a \$500 seed grant. Families with incomes between 201 percent and 300 percent of poverty would get a \$250 seed grant. All other families would get a \$50 seed grant.

Accountholders awarded seed grants would still be eligible for savings match grants outlined previously for up to five years. Combined, seed and savings match grants exponentially increase the investment earnings potential of Gift Plan accounts.

Table 9 provides a comparison between the balance of an account with both a \$500 seed grant and a 3-to-1 savings match grant and the balance of an account with no seed or savings match grant. Both balances assume a \$100 yearly contribution by the accountholder and an annual investment return of 5 percent.

Table 9: 529 Account Comparison With Seed & Savings Match

Yearly Contribution	Annual Return	Account Value after 18 years
\$100 annual deposit without match	5%	\$3,194
\$100 annual deposit with 3:1 match for five years	5%	\$6,236
\$100 annual deposit with 3:1 match for five years and \$500 seed	5%	\$7,439

The balance of the seeded and matched account, even with a very modest \$100 annual accountholder contribution, would be enough to pay for almost two years of tuition and fees, excluding room and board, at current rates at a public four-year college in Arkansas.

Another feature that could be added to the Aspiring Scholars Grant Program is more explicit incentives for elementary, middle, and secondary school academic achievement. One of the unique benefits of having a college savings account, particularly at a young age, is the incentive it provides to plan and prepare for college. Research suggests that college savings accounts do improve children's academic performance.²⁴

For example, additional grants could be provided for accountholders who enroll in quality pre-kindergarten programs, or who successfully complete elementary, middle, or secondary school. Alternatively, a small grant could be provided for every semester an accountholder makes the honor roll through high school graduation. There are a myriad of options for adding this kind of incentive grant.

Finally, another feature that should be added is college preparation activities for accountholders who are nearing college enrollment. Some of the best need-based aid programs, such as the 21st Century Scholars Program in Indiana, provide workshops, preparation courses, and college days for scholarship recipients so that they are adequately prepared to apply for and enroll in college. Having the money to pay for college is critical, but the next step of selecting and getting ready to go to the right college is equally critical. This kind of information is particularly important for first-generation college students, which are a key target population for the Aspiring Scholars Grant Program.

Cost Estimate

Precisely estimating the cost of the savings match grant of the Aspiring Scholars Grant Program is difficult. Every state that has created a savings match grant has faced this challenge. The strategy for avoiding state funding obligations that cannot be met is to stipulate that the savings match grant is contingent upon available funding. The Aspiring Scholars Grant Program would provide matching grants on a first-come, first-served basis until available funding is exhausted.

There is data available that sheds light on the potential cost of a savings match grant for Arkansas. A recent Southern Good Faith Fund publication estimated that 235 current Gift Plan accountholders might be eligible for the savings match. This estimate was based on the average percentage of 529 plan accountholders (1.4 percent) receiving savings matches in several states that have enacted savings match grants. If all 235 accountholders received the maximum annual match of \$300, the annual cost would be \$70,500. The total first year cost of several states' savings matches were between \$40,000 and \$80,000.

Of course, a more accurate cost estimate would have to take into consideration the number of eligible individuals who might open new accounts to take advantage of the savings match grant. Unfortunately, this number cannot be predicted with any accuracy simply because people's savings behavior is difficult to accurately predict.

What can be estimated is the maximum potential cost based on the maximum potential number of eligible new accountholders. This can be determined by the number of children younger than 13 in Arkansas households with annual incomes below 300 percent of poverty. Based on 2006 Census data, there are roughly 383,000 children who currently fit that profile. If every child opened a Gift Plan account and received the maximum \$300 annual match under the Aspiring Scholars Grant Program, the annual cost would be approximately \$115 million.²⁵ No other state with a savings match grant has come anywhere near 100 percent participation, so this estimate significantly overestimates the potential cost. Furthermore, this cost would substantially decline after five years when savings match recipients have exhausted the five-year limit on eligibility.

As estimated above, an Arkansas Higher Education Trust Fund with a \$200 million first year deposit would yield \$10 million in interest revenue that first year based on a conservative 5 percent investment rate of return. This \$10 million most likely would easily cover the total costs of a savings match grant in the first year. Given an estimated yearly increase in interest revenue of \$10 million per year in the first decade of the trust fund, the interest revenues from the trust fund would certainly eventually cover the savings match cost. In any event, an annual cost cap can be established to ensure liabilities do not exceed available funding, using a first-come, first-served structure as recommended above, as other states have done.

Estimating the actual cost of the seed grant of the Aspiring Scholars Grant Program also is difficult. The actual cost depends on how many lower-income households opt to open a Gift Plan account in the first year of a newborn's life and thus receive the seed grant. As with the savings match grant, this "uptake" rate cannot be predicted with significant accuracy.

However, a rough estimate is possible of the maximum potential cost should an account be opened for every eligible newborn and receive a seed grant. In fiscal year 2005, there were 37,791 births in Arkansas.²⁶ Using estimates of the percentage of these newborns who are born into families at or below 100 percent, 200 percent, and 300 percent of poverty, and the seed grant amounts proposed for each family income group above, a total annual cost for the seed component can be estimated to be roughly \$10 million.²⁷

This estimated cost likely grossly overestimates the number of families who will open a Gift Plan account for their newborn, and thus grossly overestimates the cost of the seed grant.

Again, the seed grant can be added to the Aspiring Scholars Grant Program once the Arkansas Higher Education Trust Fund is yielding sufficient annual interest revenues to cover the cost. Based on the interest revenue estimates above, the trust fund after two years will be producing \$20 million in interest, which should be enough to cover both the savings match and seed grants. By the third year, when \$30 million in interest is estimated to be available, the trust fund should be generating enough revenues to support the savings match and seed grants.

Increase Funding for the Workforce Improvement Grant

In addition to creating the Aspiring Scholars Grant Program, revenues from the Arkansas Higher Education Trust Fund also should eventually be used to increase funding for Arkansas' only strictly need-based financial aid program, the Workforce Improvement Grant (WIG). WIG targets adult students 24 and older with unmet financial need. It is currently funded at \$3.7 million annually. The population of adult students at two-year colleges grew more than twice as fast as the population of younger students over the last five years.²⁸ Also, most financial aid programs do not serve older students who often attend college part-time. Therefore, funding for WIG needs to be increased substantially.

Need-based Young Adult Program

Revenues from the Arkansas Higher Education Trust Fund also eventually should be used to create a new state financial aid program that targets young adults who have been out of high school for more than a year but are younger than 24. As noted above, this is a segment of the potential college student population that is not being served by most state financial aid programs. Both Academic Challenge and the Governor's Distinguished Scholars, the state's two largest existing financial aid programs, only serve students who go to college within 12 months of high school graduation. Any student who waits more than 12 months to enroll in college is ineligible. Most other state programs do not serve this population either unless a student meets certain other very specific eligibility criteria. Such criteria include being in the National Guard, being the dependent of a military veteran or law enforcement officer, or pursuing a health care or other high demand credential.

Need-based Concurrent Enrollment Program

Finally, revenues from the Arkansas Higher Education Trust Fund also eventually should be used to create a new state financial aid program to serve young students who are concurrently enrolled in high school and college courses. Concurrent enrollment is an emerging strategy for increasing college enrollment among high school students, but the strategy is undermined by existing state financial aid programs.

Similar strategies aimed at getting high school students an early start on college, including the Early College High School program and Advanced Placement courses, are paid for by the state so that participating students do not have to pay tuition. Concurrently enrolled students do not receive state support. Such students are also ineligible for most state financial aid programs for any variety of reasons, ranging from not having completed the high school core curriculum, not being degree-seeking, and not having graduated from high school.

Other Higher Education Needs

It is recommended that revenues from the Arkansas Higher Education Trust Fund be used first to establish and fund the Aspiring Scholars Grant Program, including both the savings match and seed grant components. The second priority should be funding the other financial aid programs outlined above. Once these financial aid programs have been funded, revenues from the Arkansas Higher Education Trust Fund can be used for other higher education needs as determined by the recommended trust fund governing board.

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APPENDIX A: 529 College Savings Plan Details

Eligibility

Generally, any U.S. citizen or resident alien can establish a 529 savings plan for themselves or for another beneficiary, regardless of income level.

Contributions

Up to \$10,000 per year (\$20,000 if filing jointly) can be contributed into a 529 Plan without incurring a gift tax.

Alternatively, a lump sum of \$50,000 (\$100,000 if filing jointly) can be contributed in one year if the contribution is counted for five years. In addition, states may impose caps on the total amount that can be saved in a 529 Plan; Arkansas' is currently \$245,000.

Tax Benefits

529 savings plan earnings are exempt from federal income tax. In addition to the federal tax benefit, most states exempt earnings from state income tax and many states offer a full or partial state income tax deduction for contributions. When savings are withdrawn for an eligible use, they are exempt from federal income tax and most state income taxes.

Eligible Uses

Savings can be used for a variety of educational expenses, including tuition, fees, books, supplies, and required equipment. For students attending school at least half time, savings can also be used for room and board costs. If withdrawals are made for a non-eligible use, the account owner would then have to pay income taxes on account earnings plus a 10 percent penalty. Alternatively, to avoid a tax penalty if the beneficiary decides not to attend college, the savings can be rolled into another family member's account or the beneficiary of the account can be changed.

The 10 percent penalty is not assessed if the beneficiary does not use the account for an eligible use due to their death, disability, or receipt of a scholarship.

Eligible Institutions

Beneficiaries can use their 529 savings plans at any institution that is eligible to participate in federal financial aid programs administered by the U.S. Department of Education.

Interactions with Other Student Aid

Education tax credits—such as the Hope and Lifetime Learning credits—can be claimed in the same year that savings are withdrawn from a 529 plan. However, each must be targeted towards separate educational expenses.

This principle is also applied to withdrawing money from both a Coverdell Education Savings Account and a 529 Plan—total withdrawals cannot exceed total educational expenses in a given year without incurring a tax penalty.

Assets such as 529 savings plans are generally taken into account when assessing the extent to which a student should receive financial aid. Some states do not count 529 plans as an asset when calculating state financial aid.

APPENDIX B: State-Funded Matching Grant Programs

State and Plan Name	Funding	Match Criteria	Eligibility
Colorado	Subject to annual appropriation, first come, first served.	\$1 to \$1 match up to \$500/year for a maximum of 5 years.	Income of up to 200% of poverty; dependent beneficiary must not be older than 12 at the time of initial application.
Louisiana	Subject to sufficient appropriations from the state legislature. The match rate may be reduced, if needed.	2%-14% match	All state residents are eligible for at least a 2% match, but the match rate is progressive.
Maine	User fees charged to national accountholders. Terms and availability can change at any time.	With \$50 initial participant deposit, \$200 in the first year then 50% of contributions, up to \$200/year thereafter.	Family adjusted gross income of \$52,500 or less (adjusted annually through the Consumer Price Index).
Michigan	Annual state appropriation from tobacco funds settlement.	\$1 to \$3 one-time match, up to \$200, within first year of account enrollment.	Beneficiary must be no older than 6 years of age, and household adjusted gross income of \$80,000 or less.
Minnesota	Subject to an annual appropriation. If total grants exceed the amount appropriated, awards will be proportionately reduced.	15% of contributions matched up to \$300/year if income \$50,000 or less; 5% of contributions matched up to \$300/yr if income \$50,001-80,000.	Must contribute at least \$200 during year and have a federal adjusted gross income that does not exceed \$80,000.
Rhode Island	User fees charged to national accountholders. If adequate funds are not available, the maximum amount to be matched would be reduced proportionally preserving the match ratios.	1:1 match up to \$500/year or 2:1 match up to \$1,000 /year for a maximum of 5 years.	Account must be open for beneficiary at or before the age of 10. Families must be at or below the state median income to qualify, with progressive match structure. Applicant must be able to declare beneficiary as dependent for tax purposes.
Utah*	State appropriation for matches to families participating in this pilot program.	1:1 match up to \$300/year for a maximum of 4 years or until high school graduation, whichever comes first.	Income up to 200% of poverty or eligible for TANF, must commit to saving at least \$25/month in an Option 1 UESP account (money market fund).

*This is currently a pilot demonstration project. In the first phase, 50 families will be able to take advantage of the match. Phase two will include 100 additional families. After this, an assessment will be conducted.

Source: Prepared by Leslie Parrish, New America Foundation and Margaret Clancy, Center for Social Development at Washington University in St. Louis

Application Method	Matching Account	Distribution and Forfeiture Provisions
<p>Application can be made February 1-May 15 for the previous calendar year contributions. Must submit application and federal income tax return or similar evidence of income only in years which applicant wants to receive a match.</p>	<p>Matches go to separate account, owned by Collegenvest and set up in the beneficiary's name.</p>	<p>Collegenvest makes payment directly to a higher education institution based on beneficiary request. Matching funds will be revoked if beneficiary fails to make a qualified withdrawal by approximately age 22.</p>
<p>The state reviews tax return filed for the prior year or the accountholder can submit their return. The accountholder can provide notarized proof of income and proof that tax filing was not required. Otherwise, accountholder will receive the minimum 2% match rate.</p>	<p>Earning enhancement is credited directly to the accountholder.</p>	<p>If savings used for a non-designated purpose, the state will recover the earning enhancements and the interest accrued from those matching funds.</p>
<p>Application can be made through December 31 for the previous calendar year. Participants self-certify income; the Finance Authority of Maine (FAME) audits income eligibility through Maine Revenue Services.</p>	<p>Matches go to participant account, although owned and invested by FAME, and set up in the beneficiary's name.</p>	<p>After waiting for at least twelve months from when the beneficiary receives a match, they may apply for matching funds to be used to pay for qualified expenses.</p>
<p>Application must be made by September 30 for the previous year contribution. Documentation of income must be made available upon request, but not required with application.</p>	<p>Matches go to separate account, owned by the Michigan Education Savings Program. Matching funds invested in an institutional bond fund.</p>	<p>Payment sent directly to beneficiary's higher education institution. Any match funds remaining will be returned to the state when beneficiary turns 30 or if the beneficiary receives a full scholarship and the funds are no longer needed.</p>
<p>Application must be made by May 1 for the previous calendar year contributions. Must submit application and federal income tax return or similar evidence of income.</p>	<p>Matches go to separate account, owned by the state of Minnesota and linked to the beneficiary's account. Matching funds invested in a guaranteed return fund with a minimum return of 3% per year.</p>	<p>Account must be open for at least three years before a beneficiary can receive a distribution of matching grant funds.</p>
<p>Application can be made January 2-April 30 for the previous tax year. Must submit application with federal income tax return or similar evidence of income.</p>	<p>Matches go to separate account, owned by CollegeBound and set up in the beneficiary's name. Matching grant funds invested in a principal protection income portfolio.</p>	<p>CollegeBound makes payment directly to a higher education institution based on request from beneficiary. Match must be utilized within a reasonable time after the beneficiary is eligible for withdrawal or the funds will be revoked.</p>
<p>Must submit copies of past two income tax returns, proof of TANF participation (if applicable), or equivalent documentation.</p>	<p>Matches go to separate account owned by the Utah Educational Savings Plans and set up in the beneficiary's name.</p>	<p>Beneficiary gains access to matching funds once enrolled in college. Funds paid directly to the higher education institution.</p>

ment will be conducted to determine whether to continue or expand the program.



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