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HIGHER EDUCATION, HIGHER COST AND HIGHER DEBT: PAYING FOR COLLEGE IN THE FUTURE

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

EXAMINING COLLEGE AFFORDABILITY, FOCUSING ON HIGHER EDUCATION, HIGHER COSTS AND HIGHER STUDENT DEBT, AND THE HIGHER EDUCATION ACT AND ITS AMENDMENTS

FEBRUARY 16, 2007

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C O N T E N T S

STATEMENTS

FRIDAY, FEBRUARY 16, 2007

ADDITIONAL MATERIAL

HIGHER EDUCATION, HIGHER COST AND HIGHER DEBT: PAYING FOR COLLEGE IN THE FUTURE

FRIDAY, FEBRUARY 16, 2007

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 10:07 a.m. in Room SD–430, Dirksen Senate Office Building, Hon. Edward Kennedy, chairman of the committee, presiding.

Present: Senators Kennedy, Enzi, and Isakson.

OPENING STATEMENT OF SENATOR KENNEDY

The CHAIRMAN. We'll come to order. We thank all of our witnesses for coming this morning and it's a pleasure again to be with my friend and my colleague, Senator Enzi, the Ranking Member and Senator Isakson and we'll be joined by others as the morning goes along. We also have a number of students from George Washington University and the U.S. Students Association, the American Medical Student Association, even some young Democrats of America snuck in here this morning. So we want to welcome all of our students and a very interesting and worthwhile panel.

Some 40 years ago, I was here when the Senate drafted the higher education legislation. It had been an issue that had been debated and discussed prior to the early 1960s and really, the issue was what is going to be the role of national policy towards the young people of our country. Are we going to recognize as a matter of national policy that we ought to provide some help and assistance to young, talented, creative, gifted students who are able to gain entrance into our fine schools and colleges across this country? Because they are limited in terms of their family's income, their own income, are they to be denied that opportunity or is the United States of America going to say to the young people of this Nation, we're going to find a path so any individual, any student in this country, young or old alike, that is able to gain entrance into any school that they choose, will be able to put together a financial package so that they would be able to go and also be able to come out of school without the heavy indebtedness, which is so often the case today? Assistance so that students during the time of their breaks between the various classes, are talking about their books rather than talking about the size of their student loans?

With the Higher Education Act, after a long debate and discussion, an issue was whether we were going to provide help and assistance to the students or help and assistance to the universities—it was a very hotly contested debate. We made the judgment decision that we were going to provide help and assistance to the students. And at that time, 80 percent of the Federal help and assistance to the students was in the form of grants, 20 percent in terms of loans and that trend has completely reversed in the past several years.

We hear political leaders talk about our youth. We hear them talk about the future. We hear how important it is to have an educated youth because we're going to have to deal with the global economy and in order to be a leader in global economy, we're going to have to have an economy of inventiveness—and where will the inventiveness come from if we don't have the young and talented and creative students? We say that we're going to need a national security force that's going to be second to none to deal with the new kinds of threats. Where are we going to be able to get that unless we have the best and the brightest also be interested in protecting the Nation?

We say we want our democracy to function and work so that we're the model for the rest of the world in terms of our values and in terms of our respect for human dignity. Obviously, for democracy to be able to work, we need people that know the issues, understand the kinds of questions and are willing to work and pursue their views on these matters. All of this, I think, necessitates that we try and find out how we can move back to that day when we, as a nation, were making education affordable.

What we've seen now in the recent times is that more than 400,000 students who otherwise would not go to college because of financial reasons. It isn't so much even about these students, or about their own obligations but they don't want to bring indebtedness to their families. They respect their parents who have worked hard, played by the rules and now have a very small retirement income. They don't want their parents to go out and have to borrow and indebt themselves even though many do. We have an application for financial aid that is mind-boggling in terms of its complexity and difficulty. Senator Enzi, who is by training and tradition, an accountant and an observer of the flow lines of resources, is helping the young people by making sure that we're going to try and simplify that.

Finally and most of all, a focus for today, we want a student loan program that is going to work for the students. I believe that too often, the student loan program is working for the banks. How can we turn that more towards the student? I think the good, old-fashioned way—by using competition. We found out that the student loan programs needed incentives to begin the program and it seems to me, we ought to be finding out how we can try and use the concepts of incentives and competition to try and move the costs, and the interest rates down, and the Pell Grants up for those young people, and to assist those who want to go into public service, we should put a cap on what they're going to have to pay out of a limited salary as a school teacher, working in child care, working as a legal assistant in public service, a whole range of public service jobs. If they're making $25,000, $28,000 in a career, and are trying to give something back into the community, give something back to their country, we'll ensure they're not going to be overwhelmed by student debt and that they will have their debt forgiven after a period of 10 years.

So we have a plan but we are fortunate this morning to have people that have looked at these issues and studied them in depth and we're very grateful for the opportunity to listen to them. I'll put my full statement in the record and I'd ask Senator Enzi for whatever comments he'd like to make.

[The prepared statement of Senator Kennedy follows:]

PREPARED STATEMENT OF SENATOR KENNEDY

I welcome our colleagues and witnesses for our hearing this morning on the increasingly serious problem of college access and affordability. It's affecting countless young people's basic life choices, from choosing a career to getting married, to buying a house and starting a family.

I have a few charts that illustrate the challenges—it's not too much to call it a crisis.

It's keeping 400,000 qualified students a year from attending a 4-year college.

It's forcing many to rule out careers in public service—such as teaching, social work or law enforcement. They may be lower paying jobs, but many find them deeply rewarding in other ways, and they bring large rewards to our society.

It's contributing to the increasing economic inequality in today's America, in which low-income and first-generation students are far less likely than others to earn a college degree, even though higher education is more important than ever to keep the doors of opportunity open in our modern society.

In a word, it's a crisis that's tarnishing the American dream for millions, and we in Congress can't ignore it any longer. Today, 60 percent of new jobs require some postsecondary education compared to only 15 percent of new jobs half a century ago.

A major cause of the problem is cost. The cost of college has more than tripled in the past 20 years, and Federal aid hasn't kept up.

Twenty years ago, the maximum Pell grant covered 55 percent of the cost of tuition, fees, room and board at a public 4-year college. Today it covers only 32 percent of those costs. As a result of rising costs and declining aid, more and more students are borrowing money to pay for college.

In 1993, less than half of all graduates of 4-year colleges used student loans to finance their education. This year, it's two-thirds.

The average college student graduates today with $17,500 in Federal student loans on graduation day. At public universities, student loan debt has more than doubled since 1993.

Last month, the House of Representatives passed the College Student Relief Act, which cuts interest rates on new subsidized student loans in half. Because the last Congress allowed interest rates to rise, typical student borrowers—already straining under $17,500 in debt—have to pay an additional $5,800 for their college loans.

The House bill would prevent this. That's good news for millions of borrowers across the country, and I commend Chairman George Miller and Speaker Pelosi for their leadership in making this legislation such a high priority at the beginning of this new Congress, and I hope the Senate will do the same.

We also need to do more to increase grant aid. Pell grants have been a lifeline to college for many low-income and middle-income students for more than 30 years. But last year, the average Pell Grant fell for the first time in 6 years. In the recent funding resolution, Congress took a significant step forward with a modest increase in the maximum Pell Grant by $260, from $4,050 to $4,310. My hope is that we can raise it to $5,100 in this Congress.

To prevent unreasonable debt burdens on students, we should cap student loan repayments at 15 percent of discretionary income, and offer loan forgiveness after 10 years to students who go into public service.

It's also long past time to reform the Federal student loan programs, so they work for students and families—not the banks. It's a scandal that has allowed these student loan programs to become corporate welfare for big lenders. We pay enormous subsidies to lenders to take part in the Federal student loan programs, and we ignored the enormous growth of the student loan industry.

Forty years ago, subsidies were needed to persuade lenders to take part. But today's, Federal subsidies make student loans the second most profitable business for banks—after credit cards. Something's obviously not right.

Of the two basic programs, the Federal Direct Loan program costs taxpayers much less than the private loan guarantee program funded by the banks and heavily subsidized by the Treasury. We need real competition between the two programs, and we could use the obvious savings from such competition to increase need-based aid.

The difference between the two Federal loan programs is obvious when you look at these charts prepared by the Government Accountability Office. Here is the program funded by the big lenders. It's an incomprehensible maze of rules and responsibilities, involving organizations the Direct Loan program doesn't need, and with money changing hands every which way.

The Direct Loan program, by contrast, is much simpler. Instead of having lenders and guaranty agencies as middlemen, the government simply lends funds directly to the students—which is one reason why this program is less expensive for taxpayers than the one funded by the banks. Clearly, the Direct Loan program is the better alternative.

In addition, the private student loan market has grown thirteenfold—thirteenfold!—in the last decade. Students deserve protection from such gouging. We also need to be the insight over the sweetheart deals that lenders and schools are increasingly making to offer these loans to students. No students should have to mortgage their future in order to pay for higher education today.

All these issues will be addressed in this year's reauthorization of the Higher Education Act.

America can't be America without an educated citizenry. It's essential to the Nation's strength. Congress rose to a similar challenge after World War II. For every dollar we invested in the G.I. bill of rights, The Greatest Generation produced $7 in economic growth, and we must do the same today, because the need is so great and the stakes for the future are so profound.

So I look forward to the testimony of our witnesses today, and to working with my colleagues in the months ahead to get the job done.

OPENING STATEMENT OF SENATOR ENZI

Senator ENZI. Thank you very much, Mr. Chairman. I thank you for holding this hearing and I am particularly pleased that we have college students here and I want to particularly welcome those from the George Washington University—that's my alma mater. I did happen to notice this last week that the Board of Trustees changed the tuition slightly and it is now the most expensive university in the United States. So help is obviously needed.

Now, we've built an important record of hearings and roundtables on these issues in the 109th Congress and I hope that when all is said and done, that we have the tools that students need to complete higher education and help them acquire the knowledge and skills to be competitive in the 21st century.

The American system of higher education is renowned. We have more than 6,000 colleges and universities and they enroll over 14-million students and provide access to all types of academic and skill-building programs. In Wyoming, we only have a handful. We have one 4-year university, public or private and seven community colleges. Our grand total of 10 accredited institutions of higher education in the State is the smallest of any State but Alaska. But that doesn't mean that we're any less concerned about a recent report by the Association of American Colleges and Universities that college graduates are less and less prepared to compete in the global economy. The American success story of higher education is at risk of losing those qualities that made it great; that's competition, innovation, access for all. Higher education will continue to be the on-ramp to success in the global economy and it's our responsibility to make sure that our young adults are able to access that opportunity and reach their goals.

The Federal Government does have a role to play in increasing affordability, which is why I support increasing the maximum Pell grant award and why this committee is working on a broader higher education re-authorization bill that will promote innovation and new technologies to keep costs down, to expand the availability of information, and to help students and parents make more informed decisions and to improve the financial literacy across the board, so that students have a better understanding of how they can manage their loans and monthly loan payments. Schools and colleges also have a role to play. They can and must do more to increase accountability and seek efficiencies to bring down the cost of education.

Also we need to explore innovative solutions to the complexity of the Federal student aid system. As Senator Kennedy said, we're trying to revise that free application for Federal student aid. I've looked into some of the reasons why it's so complicated and again, it has something to do with action that Congress has taken.

Now concern for spiraling costs of college is not new. I plan to submit for the record several articles by Dr. Richard Vedder that provide us insight into the perfect storm that is confronting our institutions of higher education.

Declining State support, stagnant productivity and students that are left without the tools they need to make informed choices about their college education. Over the last 20 years, tuition has grown at rates double the increase in family income. At the same time, productivity at our universities is declining, while more students find themselves having to take remedial classes in order to succeed in college-level coursework.

Reauthorization of the Higher Education Act is needed to address these challenges and improve transparencies in ways that will combat these hidden costs of college. Institutions must better communicate the differences between sticker price and net price of a college education and there are many students that transfer from one school to another, only to discover that their hard-earned fully paid credits will not count toward their degrees. Other students enter college without the knowledge and skills they need, requiring them to take remedial courses just to catch up and we'll be doing some things in No Child Left Behind to try and end the wasted senior year of high school. This costs students money and time and adds to the taxpayers' cost. The result is that students graduate with greater debt. It also contributes to higher attrition rates, particularly for low-income students who find themselves no better off economically but likely to be facing monthly student loan payments.

I also want to highlight an issue that I've been championing and see as a critical factor in discussing, which is student financial literacy. We must improve the financial literacy of students so they can weigh the costs and benefits of their college education options. And we can no longer assume that only 18- to 20-year-olds are at issue. We are seeing more working adults, people with college degrees and mid-career Americans pursuing additional education in order to acquire increasing knowledge and skills they need to be successful in the world economy. The choice of whether to pursue a postsecondary education is confronting millions of Americans and they need good tools by which to make those decisions.

I've been a strong advocate for financial literacy because I believe that it gives individuals the tools to understand and shape their future. Senator Sarbanes and I were the authors of legislation enabling the Financial Literacy and Education Commission to develop a national strategy on financial literacy. I should note that next week, the Department of Treasury and Education will be holding the summit on K–postsecondary education—overcoming challenges to help develop the national strategy. In addition, the summit will highlight the challenges to teaching young people about money and saving for college and the rest of their lives. We have members of the panel that have some expertise in that and I look forward to hearing from today's witnesses as we tackle these issues and get ready for that reauthorization of the Higher Education Act.

Thank you, Mr. Chairman.

[The articles by Mr. Richard Vedder follow:]

ATTACHMENT 1.—A FORTUNE IN TUITION

Tuition fees at the typical American State university rose "only" 9 percent this year, USA Today tells us, down from 14 percent last year. For every single year for over 20 years, average tuition hikes have exceeded the inflation rate. When I entered Northwestern University in the late 1950s, it took a median-income family less than 2 months' income to pay the annual tuition; today it takes over 6 months' income to pay it, at a typical selective private school.

Why is tuition soaring? According to conventional campus wisdom, it's because of declining external funding: lagging State subsidies to public universities, inadequate contributions and investment income at private ones. Schools also sometimes argue that higher tuition is funding qualitative improvements.

My own research—published in a new book, Going Broke by Degree: Why College Costs Too Much (AEI Press, 2004)—suggests that the conventional wisdom is wrong. Tuition has been growing for decades—during periods of rapidly rising as well as falling State and private funding. As to qualitative improvements, it is true facilities are nicer these days and some new academic offerings have been introduced, but at the same time the average score on the Graduate Record Exam is lower today than in 1965; it is highly questionable whether college kids are learning any more than they were decades ago.

The real reason for soaring college costs is higher demand for colleges, largely resulting from well-intended but dubious governmental policies. When demand rises relative to supply, prices (in this case, tuition fees) go up. Demand is rising partly for non-governmental reasons, such as higher incomes and a growing earnings differential between high school and college graduates. But it is also rising rapidly because of the huge growth in government loan and grant programs as well as tuition tax credits. Pell grants, Stafford and Perkins loans, tax-sheltered college-saving schemes ("529 plans"), work-study programs, etc.: All serve to increase the number of students wanting a college education at any given price. Kids without money for college simply borrow it.

ROMAN GENN

Rising tuition and enrollments have meant surging college revenues. Real per-student spending rose about 70 percent over the past 20 years. How have the universities used this extra money? Financial data provided to the Federal Government suggest that remarkably little of the higher spending has gone toward instruction: perhaps 21 cents for each new dollar per student since 1976. Teaching and learning are becoming almost secondary activities at some universities. Research has grown, but so has spending on myriad other things. Administrative staffs, for example, have soared. In 1976, it took the typical university about three "non-faculty professionals" to service each 100 students; today, it takes nearly six. My fairly typical university spends over $10 million a year subsidizing intercollegiate athletics.

Awash with funds, university personnel have taken good care of themselves too. Over the 1980s and 1990s, real average faculty compensation (including fringe benefits) probably rose about 45 percent, and near-mid-six-digit salaries are commonplace for top administrators and superstar faculty. A large proportion of tuition increases has gone not for qualitative learning improvements, but to making life better for the permanent paid members of the academy—lower teaching loads, more travel, higher salaries, etc. University presidents beg legislatures and big donors for more funds "to improve student access and academic quality," but use most of the money for fancy facilities, athletics subsidies, administrative-staff increases, and other things peripheral to the main mission of the institutions.

How can universities get away with it? Unlike the private for-profit sector, which faces strict financial discipline imposed by competition and markets, the not-for-profit modern American university is largely (although not completely) shielded from these forces. How is IBM doing? You can get real-time changing assessments of its fortunes by following its stock price, and at least quarterly estimates of its profits in press releases and stockholder reports. But how did Stanford do last year? Who knows? There is no bottom line in higher education. The closest thing to a bottom line for most high-quality schools is privately issued rankings of universities. The most influential, that of U.S. News & World Report, evaluates partly on the basis of the amount spent on inputs (e.g., faculty resources): The more the school spends, the higher the ranking.

Not only is there little financial discipline, but political or institutional accountability is lacking as well. Unlike most governmental agencies, State universities typically are largely operationally independent of their funding source, with relatively little legislative or executive oversight to ensure accountability. Boards of trustees nominally run most not-for-profit institutions of higher education (both public and private), but they are usually dominated by part-time volunteers with little time for independent exploration of campus issues, and are usually co-opted by the administration they supposedly oversee.

The sharp rise in the cost of student education suggests that productivity in American higher education is falling, certainly relative to the private sector, but probably in an absolute sense as well. While productivity is hard to measure (how do you evaluate research?), under any reasonable assumption universities are becoming relatively more costly and inefficient.

As the cost of conventional higher education rises, people seek out other options. For-profit institutions such as the Apollo Group's University of Phoenix use about one-third the resources of the typical not-for-profit to educate a student, and are both rapidly growing and extremely profitable (with pre-tax profit margins approaching 30 percent in some cases). Owing to their relative efficiency, their tuition costs are not much greater than those of some highly governmentally subsidized State universities.

There are other options. Computer whizzes are sometimes foregoing degrees in computer science to become certified in major computer tasks by Oracle, Microsoft, or Novell. Some kids are heading overseas for college, or to the relatively lower-cost community colleges instead of the more expensive State universities. In time, universities may grudgingly get serious about cost-cutting, raising teaching loads, ending tenure, slashing administrative bureaucracies, and leaving peripheral businesses (such as food and lodging operations or sports teams). But it has not happened yet—because the incentives to do so are still largely missing.

A compelling case can be made that government should get out of the higher-education business. Two arguments are used to defend public subsidies: Universities have positive externalities (spillover effects that benefit non-attendees as well as those getting degrees), and public funding expands access for lower-income students. As to the positive-externality argument, I have actually observed a negative correlation between State-government spending on universities and economic growth, controlling for other factors. Universities literally lower the incomes of non-participating citizens. And in the case of the second argument, there is only the very weakest of positive correlations between government spending on universities and the proportion of students either attending or graduating from college. (Another scandal: Over 30 percent of entering 4-year-university students do not graduate within 6 years.) The recent reduction, in some States, in government support for universities is thus sensible public policy.

One worthwhile approach is Colorado's: Allocate more money directly to students, rather than to institutions. Give scholarships (vouchers) to students who are poor, to increase their access to education—but limit the funding to those with decent academic performance (in other words, stop subsidizing party-loving mediocre students). As for the rest, let them pay their own way: They are the ones who benefit, so they should pay the bill.

Mr. Vedder teaches economics at Ohio University and is an adjunct scholar at the American Enterprise Institute.

ATTACHMENT 2.—COLLEGE IS A BAD INVESTMENT

Pouring more taxpayer money into universities doesn't lead to prosperity.

When university presidents plead for government money, they often make an argument for social investment. Pump funds into higher education and the economy will grow, they claim. After all, this is an information- and skill-based age in which college graduates are far more productive than their less-educated peers.

True. But the evidence suggests that increased public funding for universities doesn't lead to greater prosperity and may even reduce the chances of it. Compare the growth in real per capita income in States that spend a lot on higher education with that of States that spend less and a few surprises show up. Over the past 50 years low-support New Hampshire out-distanced neighboring Vermont on nearly any economic measure, though Vermont spent more than twice as much of its population's personal income on higher education (2.37 percent versus 1.15 percent in New Hampshire). Missouri, with modest State university appropriations (1.32 percent of personal income), grew faster than its neighbor to the north, Iowa (at 2.41 percent).

Similar examples abound. Using data for all 50 States from 1977 and 2002, I compared the 10 States with the highest State funding for universities against the 10 States with the lowest. The result: The low-spending States had far better growth in real income per capita, a median growth of 46 percent compared with 32 percent for the States with the highest university spending. In 2000 the median per capita income level for the low-spending States was $32,777, 27 percent higher than the median for the 10 States where higher education got the most State money.

The results were the same when controlling for a State's oilfields or other energy sources, the age distribution of its population, the prevalence of labor unions, the tax climate and other factors that could affect growth—even the proportion of college graduates. This despite the fact that the States that were growing most quickly tended to have a high proportion of college graduates.

How could this be? Colleges have devoted relatively little new funding over the past generation to the core mission of instruction (spending only 21 cents of each new inflation-adjusted dollar per student on it), preferring instead to assist research, hire more nonacademic staff, give generous pay increases, support athletics and build luxurious facilities. And while in the private sector, companies have learned to get more work out of fewer employees, the opposite appears to have happened in higher education. In 1976 American education employed three nonfaculty professional workers (administrators, counselors, librarians, computer experts) for every 100 students; by 2001 that number had doubled.

Another piece of the puzzle: Only the weakest of positive correlations links funding level and enrollment. Even if students enroll, they don't necessarily finish school. Nearly 40 percent fail to graduate within 5 or even 6 years, suggesting that many who attend universities don't much benefit from them.

Yet another explanation is one Forbes readers know all too well. Taxes reduce private-sector activity. People who must pay high taxes tend to work and invest less and also tend to migrate to lower-tax areas. In other words, increasing funding to universities means transferring resources from the relatively productive private sector to higher education, which tends to be less productive and efficient.

So what should we do? College is still a decent individual investment, certifying that the graduate meets minimum standards (often missing in high school) for competence, intelligence, maturity and literacy. But we should rethink the nature and magnitude of public support for universities. State governments, facing rising Medicaid bills and demands for primary and secondary education funding, are already slashing their support. I hope and expect this trend to continue. Big changes are coming to higher education. They are overdue.

ATTACHMENT 3.—LET'S NOT BE 3.4 PERCENTERS

The new Democratic congressional majority is voting Wednesday to lower the interest rate of some subsidized student loans from 6.8 to 3.4 percent. On the face of it, this appears as a welcome move to reduce the rising burden of student debt. Various student groups have been quick to endorse the idea.

Though I've written much about how high tuition costs have imposed increased financial burdens on college students, I oppose the new Democratic proposal. There is, of course, the legitimate Republican procedural objection that decisions of this sort should be made only after experts are consulted, evidence is gathered and presented, and reasoned debate concluded.

My concerns are different: the Federal student-loan program is already Byzantine in its complexity, and has even been harmful to some students. The Democrats' new move will do nothing to address these old problems.

A historical perspective is useful. The great growth in college participation in the United States occurred before Federal financial aid was a reality. With the single, but important, exception of the GI Bill, there were no large Federal student-aid programs before 1970.

In that year, total Federal student assistance amounted to $1.6 billion. About $1,000 per student in 2007 dollars, this was less than one-fifth the commitment today, even adjusting for inflation and the higher cost of tuition. Yet the number of college students per 1,000 Americans aged 18 to 24 grew from 23 in 1900 to 324 in 1970.

The explosion in aid began in the 1990s. From 1990 to 2000, Federal student assistance more than tripled, going from $19 billion to $63 billion, but the proportion of the population in the 18 to 24 age group going to college rose only modestly (from 506 to 545 in a thousand). Among some groups, including males, there was no growth at all over this period.

The explosion in aid has actually accompanied a slowdown in the growth in college participation. There is little evidence that the aid epidemic has increased the proportion of adult Americans who are college graduates.

Why? First, much of the increased student aid has gone to students who would have gone to college without the aid (e.g., recipients of Federal tuition tax credits, who could afford tuition in the first place).

Second, and relevant to the current debate, more Federal money increased the demand for higher education, raising sticker prices. The greater demand was not offset by supply increases, partly because prestigious colleges have put limits on undergraduate admissions.

Third, as the Education Trust showed convincingly recently, institutional financial assistance shifted sharply away from need to merit-based aid in recent times. The result? Higher tuition costs often more than offset higher aid for poorer students, so the burden of college attendance has risen, not fallen.

The real problem is not high interest rates on student loans, but exploding college costs. There are easily a dozen causes for this, but a few especially stand out.

Third parties (e.g., the Federal or State Governments, private philanthropists) pay a large chunk of the bills, rendering the customers relatively insensitive to prices (health care revisited).

Universities are mostly nonprofit institutions with few incentives to cut costs. The lack of a well-defined "bottom line" makes universities strive to improve their US News & World Report rankings, which are perversely enhanced by spending more money and restricting access.

A lack of well-defined property rights (who owns and controls universities) means the faculty is able to promote its own interests over those of relatively disenfranchised students and parents. For example, a drop in teaching loads has occurred not because of any nationally articulated research imperative, but because faculties have simply done it, with the approval of nominal bosses who politically need faculty support.

Why have universities raised tuition fees dramatically, creating the current brouhaha over student aid? Because they can get away with it. The solution to the problem is not reducing interest rates on loans, but getting the rise in college costs to remain below the income curve.

It would be far preferable simply to give students money in the form of an educational voucher and to let them use it in whatever fashion they wish than to try to artificially change the price of one of many cost items that determine the financial burden of college.

The method that the Democrats seek to pay for these new lower interest rates is predictable and problematic. The fees paid to private loan programs are to be cut, and the guaranteed reimbursement provided in cases of default are also to be reduced.

This is the strategy used in health care (cut fees to doctors and drug companies, lower costs to consumers), a move that has not stemmed the rise of health care costs, but rather threatens its quality in the long run. A similar outcome is likely if followed through in higher education.

In an ideal world, the Government would get out of the financial-aid business. Excepting the GI Bill, it has not improved access to college. Financial markets, capable of handling small loans for home repairs and car purchases as well as billion-dollar loans to giant corporations, can meet borrowing needs of individuals wanting to go to college.

And still, there is growing evidence that governmental higher education support does not promote economic growth, the rhetoric those "educrats" who benefit mightily from rising subsidies notwithstanding. Why, then, shouldn't the Federal Government limit its involvement at most to a Pell Grant program for truly low-income students, or perhaps get out of the aid business altogether?

Our great hope in stopping this express train is President Bush. One hopes he is beginning to realize that his role in history would be enhanced, not retarded, by just saying no to something. Vetoing an interest-rate subsidy bill would be a good place to start.

Dealing with Affordability Thoughts for the Affordability Task Force Future of Higher Education Commission

The Questions

Are American universities becoming less affordable, and, if so, what should we do about it? Before even attempting to answer those questions, we must ask the question: affordable for whom? The students (and their parents) who are attending college? For the Nation as a whole? For the colleges and universities themselves—are some forms of education more "affordable" to the institutions than others?

AFFORDABILITY TO STUDENTS

The Stylized Facts

Starting with the question of affordability to students, it is indisputable that the costs of college have risen faster than overall inflation and, in recent years, even faster than the rise in family incomes. Thus the financial burden of college has grown. The evidence also is that this increased burden impacts more on relatively less affluent students who are more sensitive to price, thus raising the issue of the impact of reduced affordability on educational access.

Even with higher costs, however, college "investments" are good ones for the student from a strictly financial perspective, as rising tuition charges have been roughly offset by an increase in the ratio of college to high school graduate earnings differential. Moreover, the "sticker prices" of colleges are increasingly discounted through scholarships, and student loan programs help students borrow the money to get through school. Yet even these "loans," although subsidized to some extent, represent a financial obligation to students. Also, the evidence shows that, even if one looks at the *net* tuition—gross tuition minus discounts in the form of scholarships—real costs have risen significantly faster than the rate of inflation. So even if college is a decent, even good, investment, for some there are significant cash flow problems involved in financing this investment, aggravated by the fact that close to half of the students entering 4-year programs fail to graduate within even 5 years (and for whom, consequently, the investment on balance probably does not have a high rate of return).

In addition, with respect to scholarships, it is a demonstrated fact that an increasing proportion of student financial aid has been awarded on criteria other than financial need. Income-specific data shows that, even if one controls for student academic ability, the burden of attending college is much greater for large segments of the population with below average incomes, lowering participation.

Reasons for Rising Prices

When the price of something goes up, it is either because the demand for that something has risen, or the supply has fallen (or a combination of both). The simultaneous increase in both tuition fees and enrollments over time suggest that the increase in demand is the dominant factor. Yet the increase in demand could have been offset by an increase in supply. In less technical English, colleges and universities could have used incremental funds to greatly expand capacity. Yet large portions of American higher education have not done this, including virtually all the prestigious private research universities and liberal arts colleges, and most flagship State universities as well.

When Amherst College, Northwestern University, or the University of Michigan receives an infusion of new funds from private donors or legislative appropriations, they do not use these funds to expand enrollments—the evidence is crystal clear on that. It is nearly as true of numerous less prestigious institutions as well. Indeed, institutional prestige is enhanced by *increasing the proportion of students denied admission*, and enrollment expansion potentially lowers perceived institutional reputation. Thus the incentives to expand enrollment are outweighed often by disincentives associated with that move. These factors, along with falling or stagnant university productivity and institutional emphasis on matters other than undergraduate instruction help explain the rise in college costs.

On the demand side, well-intended government financial assistance programs have been largely self-defeating. Suppose the Federal Government increases student financial aid in a year by 10 percent (actually, below the average for the years since 1994); typically within a year, the colleges raise fees by 7 or 8 percent. Since students receiving large assistance payments or loans are relatively insensitive to price, and since the supply of "slots" available is also relatively inelastic because of selective admission policies at many schools, the increase in demand induced by increased student assistance has aggravated tuition increases. Moreover, limits on assistance popular with low-income families (e.g., Pell Grants) have risen relatively modestly compared with loans to more affluent students. The student loan program is increasingly an upper middle class entitlement (students from truly affluent families have also benefited significantly from the sharp increase in nonmerit-based scholarship aid, and tuition tax credits).

Looking again at the supply side, the increase in the amount of expensive labor used to educate any given number of students (perhaps 25 percent over the past 30 years) has aggravated the problem. For example, there are six "non-faculty professional" workers for every 100 students today in American higher education, double the number three decades ago. Within the academy, there has been some shift of resources away from undergraduate instruction, some of it externally funded (e.g., Federal grant research), but some of it not. For example, average teaching loads for full professors at major research universities have fallen from perhaps 8–9 hours a week in the middle of the last century to about 5 hours today. Similar load reductions have occurred at schools with less research distinction. Institutions are using their own resources (some of them financed by tuition) to fund research via lower teaching loads. Again the incentive system is skewed. Professors are rewarded mainly for research (where the results are measurable to some extent, and thus subject to national recognition), rather than for teaching (where results are harder to measure and excellence less easy to identify and to parlay into a national reputation). For reasons of money and prestige, on average professors strive to minimize their teaching responsibilities, particularly at the research-oriented institutions. Thus universities have a lot of expensive faculty members doing modest amounts of teaching.

AFFORDABILITY TO INSTITUTIONS

The above discussion points out that many institutions find it costly to emphasize undergraduate instruction. The most student-oriented of institutions—2-year community colleges—have lost ground financially relative to 4-year schools. For example, salaries of faculty in real terms have stagnated and even fallen, while those for senior professors at leading research institutions have risen substantially. Incentives systems generally have favored an increase on emphasis on non-undergraduate activities such as funded grant research. Research garners national reputation when it is high quality, via scholarly publications and even media dissemination. Stories about effective undergraduate instruction tend to be localized in nature, and do little to enhance national prestige as measured by the *US News & World Report* survey or other rankings. It is a sad but true fact that at most American universities, faculty prestige runs inversely with faculty teaching loads. Research universities use more and more relatively cheap adjunct professors and teaching assistants to instruct lower division undergraduates at relatively low cost, while showering resources on advanced graduate students and research, not to mention a burgeoning administrative bureaucracy.

AFFORDABILITY TO SOCIETY

A greater proportion of our national resources are going to higher education, by far, than in, say 1960. That is to be expected given rising educational aspirations and increased college participation, and even today only about 3 cents of every dollar of output goes to higher education. So by most ways of looking at things, America can afford the costs. At the same time, however, higher education does not exist in a vacuum. State governments have significantly reduced institutional subsidies for a variety of reasons. The astronomical rise in Medicaid costs makes it unlikely that this trend will reverse anytime soon. Huge Federal budget deficits and what many regard as excessive spending growth over the past few years produces a climate where there will be strong resistance to radically expanding Federal aid.

The enrollment share of private schools, counting the for-profits, is growing, and the public enrollment share is declining. Moreover, many schools that are “public” are increasingly moving in the direction of privatization, with some flagship American State universities receiving only 10 or 15 percent of their budget from State appropriations. The fiscal history of the United States for a third of a century suggests that a political equilibrium is reached in the typical State when State and local taxes are at 10 percent of personal income—less than that, the political forces demanding increased governmental services often prevail, but beyond that the forces demanding relief from high taxation often are politically successful. The aggregate State and local tax burden has remained remarkably stable (around 10 percent of income) since at least 1970. It is probably unrealistic to expect voters agreeing to higher taxes to fund higher education, regardless of the entreaties of the university community.

This raises the question, “who should pay for the universities?” That answer may vary somewhat by type of institution—for example, it is probably unreasonable to ask current students to subsidize to any major degree long-run basic research efforts at the major research universities. But should the government or philanthropic institutions substantially subsidize the education of, say, students from relatively affluent homes that do a mediocre job in school, lingering around at partial public expense for 5 or 6 years? I question whether that is a luxury that we can afford.

This gets to the critical underlying issue: are the services of universities and colleges public or private goods? Do the benefits accrue to the students in attendance, or to society at large? The question is complicated by the fact universities perform multiple tasks—disseminating knowledge to students, expanding the frontiers of knowledge through research, not to mention such non-academic functions as providing food, lodging and entertainment (e.g., college athletics, theater). It is at least plausible that it may be that positive spillover effects justifying public funding are more prevalent in some activities, e.g., scientific research, than in others, e.g., student instruction, research in the social sciences and humanities, intercollegiate athletics.

Universities claim, with only minimal solid evidence, that they are important in promoting economic development. It is unquestionably true that advanced economies need lots of "human capital" and that a basic intellectual infrastructure is necessary for major technological innovation. That does NOT prove, however, that spending NEW or incremental dollars on higher education will have a high payoff. My own research with respect to State government appropriations suggests that it does not, and hints that the positive externalities or spillover effects present in public goods may not be present in higher education today at its current level of funding and with the current system of delivering educational services. I may be wrong, but the empirical basis for claims to the contrary is pretty slim.

One factor in declining governmental support at the State level for higher education is a growing sense that the independence of universities, granted to insulate them from political pressures and allow academic freedom, may have bred a decline in institutional accountability. Who watches the universities? How do you even evaluate how they are doing? Often it seems universities embark on missions on their own and expect society to pay the bills. They do not require either legislative action or stockholder approval for most of the things they do. Thus teaching loads fell over time not because of a conscious national policy decision to lower them to support research, but because universities simply did so, almost by stealth, over a period of decades. Undergraduate instruction received less attention not because of public policy decisions, but because of institutional actions favoring more prestigious graduate programs, research, intercollegiate athletics, etc.

GROPING FOR SOLUTIONS: SOME IDEAS

It is mathematically impossible for the costs of education for students to rise faster than family income on a sustained basis (costs *can* rise faster than inflation almost indefinitely and have in some areas of the fine arts, as William Baumol has argued). Therefore, even without Commission action, some move towards lowering the tuition cost explosion is inevitable.

I think a sharp slowdown in the growth in Federal aid programs would help reduce the growth in tuition costs. I think also that institutional efforts to increase merit-based assistance relative to need-based aid has added to the access problem, although it must be acknowledged that many underrepresented groups are largely underrepresented because of poorer academic performance at the K–12 level rather than economic access barriers.

A revamping of Federal student loan programs seems warranted. Loan eligibility should be restricted more. Students from higher income families should not receive federally subsidized assistance. Poorly performing students should be subject to loss of aid. Also, just as we now put time limits on welfare payments, we should do so on loan eligibility—perhaps 4 years for full-time baccalaureate students. At the same time we should increase assistance for lower income students to minimize access problems. One approach would simply be to increase the amounts available for Pell Grants. An alternative, perhaps more promising approach would be to convert Pell Grants into Equal Opportunity Scholarships working like vouchers, where awards are made to students usable at any accredited institution of higher education. Encouragement should be given to States to convert more of their higher education support into grants to students rather than to institutions. This should increase somewhat competition for students, perhaps reverse the relative neglect of undergraduate instruction, and simply make explicit what is already happening: the move towards privatization of State-supported institutions. Vouchers could be both performance-based and progressive—more to low-income kids, more for good students than bad.

It may be possible to restructure Federal tax policy in a revenue-neutral way that would better support national educational objectives. People take tax deductions for contributions to non-academic enterprises at universities, like athletic facilities. Rich schools with predominantly affluent students and annual endowment income exceeding $50,000 per student, such as Harvard and Princeton, receive gifts treated the same for tax purposes as schools with almost no endowments serving predominantly lower or middle income students. Perhaps deductions to "rich" schools should be restricted, and donations to poorer schools (public or private) be encouraged, possibly by the use of tax credits. Perhaps a National Scholarship Foundation should be created funded by tax credits financed partly by restrictions in tax write-offs for gifts to extremely affluent schools or for non-academic purposes such as stadium renovations. Along the same lines, to improve access perhaps we should restructure governmental assistance to aid lower cost schools that clearly use incremental funds to increase capacity. Per-student costs can be reduced significantly simply by shifting the mix of students more to lower cost institutions.

Barriers to entry into offering education services should be scrutinized. Recently, for-profit schools have begun buying up small not-for-profit schools mainly to obtain accreditation. Accreditation is costly and excessively input rather than outcomes based. Admittedly there are trade-offs here: loosing accreditation rules increases risks of non-legitimate diploma mills not only existing, but obtaining Federal funds for their students.

More radically, perhaps we should encourage (require?) universities to separate their teaching and research functions. Professors would work for the University of Michigan for instruction, and for the University of Michigan Research Institute for their research. This might lead to improvements in the transparency of university finances, and could ultimately lead to a new research model. Perhaps we should also revamp Federal research grants, making them more purely competitive instead of grants given to monopolists (the sole proposes of a research project) based on some sense of merit. A standardized and simplified national overhead policy for research also makes great sense.

The Academic Arms Race of spending more and more to obtain higher rankings on the *US News & World Report* and similar surveys should be discouraged. How? One approach is to offer new ways of evaluating university quality. For example, administer an entrance and exit general education test at all schools accepting federally assisted students, similar to the NAEP examination used at the K–12 level. One possibility is the new Collegiate Learning Assessment test developed by the Rand Corporation and already used at over 120 colleges. The Federal Government would then publish the “value added” at each school. Accreditation could be more tied to this outcomes-based measure. This examination, depending on the nature of test used, might also have the secondary benefit of dealing with an abysmal decline in knowledge of basic facts about our heritage, encouraging schools to beef up their general education curricula and take seriously a U.S. Senate resolution to require some study of history in college. To deal with another national higher education malady, Federal assistance could be barred to schools where the average student grade for the total student population is above, say, a “B” average. Grade inflation has contributed to declining standards and needs to be addressed.

Some rewards should exist for schools that hold the line on costs, and take cost-cutting seriously, for example by using technology more intelligently to reduce costs. What would happen, for example, if the Federal Government awarded $1 billion annually to schools in the top 10 percent of institutions in terms of meeting efficiency criteria (e.g., changes in expenditures per student, most incremental value-added per dollar spent, etc.), with the stipulation that 10 percent of the funds would go to efficiency bonuses to key employees? At the moment, the pressures are intense from tenured faculty and powerful deans for university presidents to recommend big budget increases. Those pressures should be counteracted by incentives to economize.

These are just a few suggestions to “wet the appetite” for discussion of serious reform.

[The prepared statement of Senator Enzi follows:]

PREPARED STATEMENT OF SENATOR ENZI

Thank you Senator Kennedy for holding this hearing and continuing our work on the reauthorization of the Higher Education Act. We built an important record of hearings and roundtables on these issues in the 109th Congress. I hope when all is said and done, students will have the tools they need to complete higher education and help them acquire the knowledge and skills to become competitive in a 21st century economy.

The American system of higher education is renowned throughout the world. Our more than 6,000 colleges and universities enroll over 14 million students and provide access to all types of academic and skill building programs. In Wyoming we only have a handful of the total—one 4-year university, and seven community colleges. Our grand total of 10 accredited institutions of higher education in the State is the smallest of any State but Alaska.

However, we are no less concerned about a recent report from the Association of American Colleges and Universities that college graduates are less and less prepared to compete in the global economy. The American success story of higher education is at risk of losing the qualities that made it great—competition, innovation, and access for all. Higher education will continue to be the on-ramp to success in the global economy, and it is our responsibility to make sure that our young adults are able to access that opportunity and reach their goals.

The Federal Government has a role to play in increasing affordability, which is why I support increasing the maximum Pell Grant award, and why this committee is working on a broad higher education reauthorization bill that will promote innovation and new technologies to keep costs down, expand availability of information to help students and parents make more informed decisions, and improve financial literacy across the board so that students have a better understanding of how they can manage their loans and monthly payments. Schools and colleges also have a role to play. They can and must do more to increase accountability and seek efficiencies that bring down the cost of education.

Also, we need to explore further innovative solutions to the complexity of the Federal student aid system. Right now filling out the Free Application for Federal Student Aid (FAFSA) prevents many students from even considering college. That was never our intent and it is time to make the FAFSA less complicated than filling out our tax forms—and for an accountant to say that, is really something. One interesting solution I've heard, and I hope to hear other suggestions today, is the possibility of rolling the financial aid process into the existing tax system. We need to explore this and other approaches to making sure that we improve the FAFSA to help students get timely and useful information about what resources they have available to pursue higher education.

Concern for spiraling costs of college is not new. I plan to submit for the record several articles by Dr. Richard Vedder that provide us insight into the perfect storm that is confronting our institutions of higher education: declining State support, stagnant productivity, and students that are left without the tools they need to make informed choices about their college education.

Over the last 20 years tuition has grown at rates double the increases in family income. At the same time productivity at our universities is declining, while more students find themselves having to take remedial classes in order to succeed in college-level coursework. Reauthorization of the Higher Education Act is needed to address these challenges and improve transparency in ways that will combat these hidden costs of college.

Institutions must better communicate the difference between the "sticker price" and "net price" of a college education. And there are many students that transfer from one school to another only to discover their hard-earned, fully-paid credits will not count toward their degrees. Other students enter college without the knowledge and skills they need requiring them to take remedial coursework just to catch up. This costs students money and time, and adds to taxpayers' costs, too. The result is that students graduate with greater debt. It also contributes to higher attrition rates, particularly for low-income students, who find themselves no better off economically, but likely to be facing monthly student loan payments.

I also want to highlight an issue that I have been championing and see as a critical factor in this discussion—student financial literacy. We must improve the financial literacy of students so they can weigh the costs and benefits of their college education options. And we can no longer assume that only 18–22 year olds are the students being served by these programs. We are seeing more working adults, people with college degrees and mid-career Americans pursuing additional education in order to acquire the increasing knowledge and skills they need to be successful. The choice of whether to pursue a postsecondary education is confronting millions of Americans, and they need good tools with which to make those decisions.

I have been a strong advocate for financial literacy because I believe that we must give individuals the tools to understand and shape their future. Senator Sarbanes and I were the authors of the legislation establishing the Financial Literacy and Education Commission to develop a national strategy on financial literacy. I should note that next week the Departments of Treasury and Education will be holding the "Summit on K–Postsecondary Education—Overcoming Challenges" to help develop the national strategy. In addition the Summit will highlight the challenges to teaching young people about money and saving for college and the rest of their lives.

I look forward to hearing from today's witnesses as we tackle these issues in the reauthorization of the Higher Education Act.

The CHAIRMAN. Thank you very much. We are very fortunate with our panel this morning. Suze Orman is a two-time Emmy Award winner, television host and a New York Times best-seller author, magazine and online columnist, writer/producer, motivational speaker, one of America's most recognized experts on personal finance. Ms. Orman has written five consecutive New York Times best sellers and lectured widely and is a certified financial planner and Director of the Suze Orman Financial Group and Vice-President of Investments at Prudential Based Securities and was an account executive at Merrill Lynch. Prior to that, she was a waitress at Buttercup Bakery in Berkeley, California, from 1973 to 1980.

Tamara Draut oversees Demos' research policy advocacy work on issues related to economic security and mobility and is the author of Strapped: Why American's 20- and 30-Somethings Can't Get Ahead, published by Doubleday in 2006. Her research focus is on the growing debt burdens facing low- and middle-income households, and more broadly, the challenges confronting households trying to educate their way into the middle class. She is the author of a number of superb books. Her research has been covered extensively by the Times and Washington Post and television networks.

Jon Oberg is a former staff member who worked for years at the Department of Education. He has four decades of experience in higher education finance at the institutional, State, Federal, and international levels. His experience includes that of Chief Financial Officer in his home State of Nebraska; staff on the U.S. Senate Budget Committee; President of an Association of Colleges and Universities; and legislative liaison to Congress in 1998 for the U.S. Department of Education, during the reauthorization of the Higher Ed Act. He holds a Master's degree from the University of Nebraska and earned a Doctorate from Free University of Berlin.

Sandy Baum is a Professor of Economics at Skidmore College, and Senior Policy Analyst at the College Board. Dr. Baum earned a BA in Sociology at Bryn Mawr College, Ph.D. in Economics at Columbia, and has written extensively on issues relating to college access, college pricing, student aid policies, student debt, affordability and other aspects of higher education. Dr. Baum is the co-author of Trends in Student Aid, Trends in College Pricing, and Education Pays, the Benefits of Higher Education for Individuals and Society, for the College Board.

So we have a very good panel here and we'll start off with Ms. Orman. Thank you very, very much for being here and I look forward to hearing from you.

STATEMENT OF SUZE ORMAN, HOST, THE SUZE ORMAN SHOW, CNBC

Ms. ORMAN. Thank you very much for inviting me to be here. I was listening to what all of you were saying in terms of how this is a problem that affects our students. I'm here to say it doesn't just affect our students. This is the perfect storm that is going to affect, in my opinion, the entire economic environment of the United States of America and let me tell you why.

With the convergence of obviously, student education rising, we have also had the increase of real estate, the increase of gasoline prices, the increase of utilities, the increase of property taxes, the increase of simply being able to just live every single day. What that has done to the parents of these students, it has put them in a situation where there is no extra income whatsoever. They are barely making it. Most of them have extreme credit card debt. None of them have money put towards a savings or a retirement account of their own and what are they doing? They are trying to help their children obtain an education, become something. They are raiding their own coffers at a time when they do not have the ability to save any more because costs are too expensive. So we now are creating an economic family that is failing on every single level.

The number one call now into my show is this: it is from a student who is worried about two things. How are they going to repay their student loan and what can they tell their parents because their parents are out of a job, their parents aren't making it and they are worried to death about their parents. So the burden on the shoulders of these students is greater than I've ever seen in my life.

They aren't going to school. They don't want to go to school or if they do go to school, they come out with such horrific debt that they feel that they cannot take a job in the career that they would like to pursue, possibly a career that they were educated in because they have got to take any job that will allow them to live, pay their bills and just get by.

So as I just briefly said, this is a perfect storm that is brewing out there, that is going to affect every single person in the United States of America. Shame on the colleges for what they charging, truthfully. Shame on the big business behind these students loans and what they are charging and how much money they are making off of our children's future. Shame on all of them. I see it every day. I am sure there is not one person in the entire world that speaks to as many people, one on one, as I do about their own personal financial situation. Henceforth, I wrote my last book called, The Money Book for the Young, Fabulous and Broke. I should have written it, the Young, Fabulous, Depressed and Broke. They are depressed because they are graduating school and college at a time when student loan debt is more than their grandparents paid and parents paid for all the real estate they ever purchased, when gasoline, as I said, is exorbitant. Many of these jobs are being shipped offshore. They don't know what to do and really, they are depressed and when they are depressed, they don't even try. So this is a grave, grave situation that we are facing here and again, in my opinion, it will become the reason that the United States of America loses all economic strength, power and everything in the future and what is so sad is we are doing it to ourselves.

[The prepared statement of Ms. Orman follows:]

PREPARED STATEMENT OF SUZE ORMAN

Chairman Kennedy, I am so grateful for the opportunity to address this committee today on the need to increase the affordability of student loans for our country.

I say for our country, not just for prospective college students, because I fervently believe that this issue has an enormous impact on every American. Our ability to educate our citizens so they not only can compete in a global economy, but can be *leaders* in a global economy is, for my money, one of the most important priorities we can set for our country. Our future rests on the success of postsecondary education. The move last year to cut $12.7 billion in Federal student aid funding was a dangerous step in the wrong direction. If we do not take the steps today to make college more accessible and affordable, we are mortgaging our future as economic leaders.

- **The increasing cost of college is a barrier to obtaining a 4-year degree.** As you have detailed, each year 400,000 low-income students do not seek a 4-year college education because of cost issues. Those are 400,000 potential leaders that are not getting the opportunity they deserve, and that we as a nation need them to have.
- **The increasing cost of college saddles recent graduates with a high level of debt that is both a financial and career impediment.** The average undergrad leaves school with about $20,000 in student loan debt—that is a 25 percent increase since 2000.* Dare to seek an advanced degree and that sum triples. It is easy to see how those large sums are a costly burden for our young adults.

I hear from thousands of young adults each year—on my television show, at speaking engagements and through my Web site—about how defeated they feel before their career even starts, given the huge student loan debt they have to pay off. I am the first to say student loans are "good debt"; we have all seen the studies that show a college degree can produce an extra $1 million in lifetime earnings. But when you are in your early twenties, with $20,000 or $60,000 or more in student loan debt and a starting job that doesn't pay too much, you aren't in a position to feel good about the potential lifetime payoff for your degree. Your reality is that you have a lot of debt that you feel pressured to pay off. And that debt load affects your entire financial life.

Young adults with big student loans to pay off tell me they feel tremendous pressure to "just get a job that pays" when they graduate, rather than pursue a career that they are passionate about. A work force of 20-somethings that feels they can't afford to pursue careers that aren't highly compensated does not bode well for our Nation.

And the student loan burden has a snowball affect on their broader financial life: The rapidly increasing price in home values across the Nation over the past 5 years or so has made buying a *first* home a struggle for so many young Americans. When you add in the fact that they are already loaded down with student loans, the prospect of adding on mortgage debt either becomes unthinkable, or pushes them into making dangerous decisions, such as buying a home with a negative amortization loan because they feel that's all they can afford . . . only to learn later on what a big mistake they have made.

But the biggest mistake I see young adults make is to ignore them altogether. They are so overwhelmed by what they owe and can't fathom how they will ever be able to dig out from their debt hole that they make the horrible decision to ignore the loan. And then they come to me absolutely depressed when they find out that their loan has kept mushrooming as the interest payments are added onto the principal, and their personal credit scores are a mess because of their failure to make timely payments on their student loans. Irresponsible? Of course it is. But there is blame to go around. The fact is we are doing a lousy job of educating our children about finances. About how money works, about how loans work, and most importantly about being fiscally responsible. I applaud the proposals put forth by this committee to address ways to financially ease the burden of student loan debt, but I encourage you to also address the need for more and better education on how to handle student loans in the repayment period. It is a failure on our part when we hand money to young adults—be it credit cards or student loans—without truly making sure they understand the mechanics of how these agreements work, and give those young adults the information they need to act responsibly.

Moreover, young adults are absolutely clueless that how they handle their student loans will have a tremendous impact on their future finances. They are shocked when I explain to them that their loan repayment history plays a major role in determining their credit score. When I explain to them that failure to keep up with timely student loan payments is going to lead to getting offered lousy rates on home mortgages and car loans, or could even impact their ability to land a job or rent an apartment, their financial depression just deepens.

Another major education black hole is the issue of loan consolidation. Far too many young adults eligible for loan consolidation missed the boat on this valuable financial move when interest rates were so low in 2005. When I hear from young adults in a financial mess and I find out they have unconsolidated student loans, they invariably tell me they don't understand how consolidation works and are just too afraid or overwhelmed to figure it out.

I have no easy answers when young adults weighed down with student debt come to me for help. There are no magic moves for someone who owes hundreds of dollars a month on their student loan, but they can't even afford the rent on their apartment, food, and other basics because starting salaries these days—high quality jobs with a promising career path—are harder and harder to come by. Two years ago I wrote *The Money Book for the Young, Fabulous & Broke*; it tackles all the financial challenges today's young adults face. But I made a mistake. It should have been titled, The Money Book for the Young, Fabulous, Broke *and Depressed*. So many young adults want to do the right thing, to be financially responsible. But they are justifiably depressed at how to pull it off. Just consider the scope of what they face: The cost of their student loans exceeds what their grandparents probably paid for all their homes. I challenge anyone on this committee to contemplate how they would have handled tens of thousands of dollars in student loan debt right out of school, when they are lucky to land a job with an annual salary that is but a fraction of their student debt.

Yet I have not changed my mind: student loan debt is indeed the best kind of debt; it is an investment toward building a better future. But we need to do more to make that debt manageable for young Americans. And to demystify how it all works, so they can make the right moves right out of the starting gate when they graduate. We need to help financially and educationally.

- **The student loan crunch is financially destabilizing for parents as well as students.** One of the most overlooked aspects of our Nation's current student loan approach is how it affects the parents of these children. Once again, I come to you with real life experience: no matter the venue, every day I hear from parents who have literally mortgaged everything to be able to send their kids to college. They have used a home equity line of credit, or they have made saving up for their kids' college funds a priority at the expense of not setting money aside for their own retirement. Or they raid their 401(k) savings to pay for college. Noble you say? I beg to differ. As well-intentioned as every parent is, this is going to potentially lead to a huge national problem down the line: without the necessary retirement assets, how do we expect today's parents to take care of themselves when they stop working? And don't tell me they will have great home equity to fall back on . . . not when they took out a $50,000 or $100,000 home equity line of credit to pay for each child's college education.

I wish you all could hear the frustration and sadness so many young adults share with me when they learn exactly what their parents did to help them go to college. Unfortunately they learn too late: after they are out of college and just starting out, Mom and Dad tell them they have little money to retire on, and the house is mortgaged to the hilt.

I hope all members of this committee and all Members of Congress will keep in mind the inter-generational impact of our student loan policy. The more accessible and affordable the loans are for students, the less debt parents—and grandparents—will have to take on to help their loved ones get a college degree. That is not just good for those families; it is sound national economic policy. Do we really want an elderly population that is not prepared to support themselves in retirement because they chose to send their kids to college rather than fund their 401(k)s and IRAs?

Revamping the current Federal student loan program to be both more affordable and more accessible will enhance our Nation's financial strength. It will produce a workforce that can lead a global economy. It will lead to a more stable economy where young adults are not buried with so much debt they can never see their way out, and it will allow their parents to focus on what we as a country need them to focus on: building the necessary savings to support themselves in retirement.

I fully support recent proposals put forth by members of this committee:

- **Reducing student loan interest rates.** Yes, this is a subsidy. Why are we so afraid to use that term? We should be proud to state that we are subsidizing education. It is an investment in our collective future. The current fixed 6.8 percent rate on Stafford loans should at the very least be reduced for college students that qualify for subsidized loans; we owe it to them and our Nation to help them receive an affordable education. Ideally we can also find a way to extend lower interest rates to those students with unsubsidized Stafford loans.
- **Increase the Pell grant limits.** Raising the current $4,050 limit to above $5,000 will go a long way to easing the financial stress of so many families.
- **Consider increasing the income limits for deductibility of student loan interest.**
- **Make sure loan repayment rules are not too onerous.** We need to help young adults juggle a daunting array of financial obligations. Yes, they need to pay off their student loans. But they also need to pay the rent and I think we all agree that it would be beneficial to them and for us as a nation if they also started funding a Roth IRA and contributing to a 401(k). That's a lot to handle all at once. I think one way this committee can help out is to review the required repayment rules for student loans. By capping the maximum annual repayment required at a reasonable percentage of income and by offering extended repayment schedules, you can make it easier for young adults to tackle multiple financial goals simultaneously. I know these issues are already on the table. But I also want to suggest one additional way to help young adults pay off their student loans: make it possible to refinance consolidated student loans. As you know, consolidation whereby a debtor locks in one fixed interest rate for the life of the loan is currently a one-time deal. I can not tell you how many adults in their late 20s and early 30s who consolidated when rates were much higher are now so frustrated to still be paying high interest rates on their old debt.

The CHAIRMAN. Thank you.

Dr. Draut.

STATEMENT OF TAMARA DRAUT, AUTHOR AND DIRECTOR OF THE ECONOMIC OPPORTUNITY PROGRAM, THE DEMOS INSTITUTE, NEW YORK, NY

Ms. DRAUT. Thank you for the opportunity to testify here today. You know, going to college represents more than simply trying to make more money. For parents themselves who didn't go to college, it is their best option of ensuring that their children have a better life than they had and that their children's children have a better life than they had.

As our Nation's primary lever to economic opportunity and social mobility, ensuring that students have the ability to go to college is an important tenant of the American Dream and of our social contract and is the Federal financial aid system that should be and serve as the primary gateway to this opportunity.

Today, I believe the Federal financial aid system is failing on its basic premise, which is that if anyone wants to go to college and is capable of doing the work, they will be able to do so regardless of their family income. We all know that tuitions have skyrocketed, Federal financial aid, particularly grants, has grown anemic. These two forces combined have created what I call a debt-for-diploma system.

I want to focus today on two aspects of the debt-for-diploma system. One is the impact it has on whether low-income or first generation students will enroll or complete college and also the unrealistic assumption that today's average student loan debt is something reasonable for young people to assume.

Today, two out of three undergrads leave school with about $19,000 in student loan debt. It's about $17,000 for those who go to public colleges and universities. Even community college students are no longer immune from relying on loans to help pay for college. They are leaving with about $8,700 in average student loan debt. Now, in many ways, these statistics about student loan debt represent the fortunate individuals. After all, they went to school and they graduated. Left out of these are the people who forego college altogether or drop out because the cost has become too high and the Federal financial aid package too low.

Rising tuitions and anemic Federal aid have gotten us to a perverse reality today, where the highest achieving poor kids go to school at the same rates as the lowest achieving rich kids. According to the Advisory Committee on Student Financial Assistance, financial barriers prevent 48 percent of low-income families from going to a 4-year university. Financial barriers prevent 22 percent from enrolling in any college at all and unmet financial need is a major reason why college remains out of reach for these young people.

Now I want to step back to those who do enroll in college. These students are taking on student loan debt by the thousands, the overwhelming majority who attend our public colleges have about $17,000 in debt. That's a figure that has more than doubled in the last decade. But not all students borrow at the same amounts and indeed, this is where low-income students are hit with another punch. In 2004, 88 percent of Pell grant recipients had student loans, compared to just over half of those who did not have Pell grants. Pell grant recipients also carried about 12 percent higher debt than those without Pell grants.

So why should we care that the Federal financial aid system is now what I call a debt-for-diploma system.

The CHAIRMAN. Just on that point about the indebtedness of those that are the lowest income. What's the significance? Could you expand on that, the significance of that again, for me?

Ms. DRAUT. Absolutely. The impact is that these are students who come from households where when they graduate from college, they will not be able to fall back on parents if they are having trouble making the rent or they're having trouble making a car payment. These are, by and large, first generation college students, so their average student loan debt burden that is now higher than those without Pell grants means they are going to have an enormous time trying to make those payments and they don't have a safety net in the form of parental resources, which is one of the reasons why it is so difficult to draw a line in the sand about what is reasonable student loan debt today and I'm going to touch on that.

Indeed, I don't think we should be trying to draw a line in the sand. We should be trying to figure out what is the best way to make it possible for people to afford college and I submit to you that it is not a debt-for-diploma system, that in order to sort of right this ship, we need to get back to a system that is much more based on grants than on debt.

In the written testimony, I've put forth what Demos—the proposal that Demos has put forth, called the Contract for College. Basically, it's a contract because it says to students as early as seventh grade, if you want to go to college, you can and here's how much financial aid you will qualify for, based on the IRS returns of your parents last year. We need to let students know earlier the types and the amount of financial aid available for them and I believe we have the technology to do that.

The second thing it would do is provide a sliding scale of grants so that if you have lower income, you can get a grant that will cover, for the lowest income students, three quarters of the cost of going to college.

I hope that we will get into some particulars about how we can make the system, the higher education, more affordable and accessible without requiring the ordinary student to take on inordinate amounts of student loan debt.

[The prepared statement of Ms. Draut follows:]

PREPARED STATEMENT OF TAMARA DRAUT

Chairman Kennedy and Ranking Member Enzi, thank you for the opportunity to testify today on issues of access and affordability in higher education. In my role as the director of the economic opportunity program at Dēmos, a nonprofit, nonpartisan research and public policy organization, I have studied and written critically about the decaying access and affordability crisis that now characterizes our higher education system.

As the primary lever for economic and social mobility, access to higher education is vital to this country's ability to make good on its promise of equal opportunity and upward mobility. The Federal financial aid system is fundamental to fulfilling the promise of providing a college education to anyone who desires self-improvement and is committed to the work necessary for advanced study. As the primary source of financial aid for most students, the effectiveness of the Federal panoply of grants and loans is paramount to ensuring college remains accessible and affordable to all students, regardless of their economic background.

Today, rising tuition and anemic Federal financial aid has created what I call a "debt-for-diploma system." The debt-for-diploma system affects young adults' choices about college, including where they enroll and whether or not they complete their degree. The debt-for-diploma system also exerts powerful influence on young adults even after they leave college. With two out of three undergraduates leaving school with student loan debts averaging $19,300 ($17,500 for those attending 4-year public universities), the debt-for-diploma system continues to exert its influence in young adult's lives—impacting their financial stability long after they've accepted their diploma.

During my testimony, I will focus on the intertwined issues of access and affordability by discussing the following:

1. Trends in access, enrollment and completion in higher education by income and race/ethnicity;
2. Trends in State funding of higher education and its impact on tuition costs at 2- and 4-year colleges and universities;
3. Trends in student loan debt and Federal financial aid, including the purchasing power of the Pell Grant and shifts in the composition of aid;
4. The larger economic context facing young adults; and
5. A proposal Dēmos has developed to strengthen the Federal financial aid system so it again delivers on the promise of ensuring access regardless of family income.

TRENDS IN ACCESS ENROLLMENT AND COMPLETION

Today, thousands of students are being denied access to postsecondary education simply because it is unaffordable. Thousands more enroll but drop out before obtaining a degree. In the 2001–2 school year, over 400,000 *college-qualified* high school graduates from low- and moderate-income families (those with incomes below $50,000) did not enroll in a 4-year college, and 168,000 did not enroll in any college at all.[1] Unless immediate steps are taken to reverse this trend, over the decade 4.4 million qualified students will not attend a 4-year college and 2 million will not attend any college at all. The wide disparities in access to higher education run counter to our values of fairness, equal opportunity and upward mobility. In 1965, with the creation of the Higher Education Act, our Nation set out to ensure that any student who wanted to pursue a college education should have the opportunity, regardless of family income. While we've never fully delivered on that promise, we are now losing ground.

According to an analysis of data from the Department of Education, low- and middle-income households face high levels of unmet need.[2] Unmet need equals the cost of attending college, including tuition and living expenses, minus expected family contribution and financial aid. According to the report, the average public college student from a family with an annual household income of $62,240 or less will have an average of $3,600 in annual unmet need. Public college students from families with an annual household income of $34,288 or less will experience an average annual unmet need of $4,689. Students who face unmet need compensate by working longer hours and/or by taking out private student loans. These calculations of unmet need only apply to those students who are enrolled, not the 168,000 who do not enroll at all due to financial barriers.

As a result of unmet need, the *highest* achieving students from poor backgrounds attend college at the same rate as the *lowest* achieving students from wealthy backgrounds.[3] Or to put it more coarsely: the least bright wealthy kids attend college at the same rate as the smartest poor kids.

- Gaps in enrollment between low-income families (below $25,000) and high-income families (above $75,000) are as wide as they were three decades ago.[4]
- Although roughly three-quarters of high school seniors continue their studies, only half receive a degree 5 years after studying, and only a quarter receive a bachelor's degree or higher. Students from low-income families complete degrees at a much lower rate than their wealthy counterparts: only 21 percent of low-income students who enroll in college will complete a bachelor's degree—compared to 62 percent of high-income students who enroll.[5]
- The degree completion rate is much more disparate as a percentage of *all* students, not just those who enroll. Forty percent of students in the top quartile graduate with a 4-year degree, compared to only 6 percent of students in the lowest quartile.[6]
- One third of college entrants drop out before their second year. First generation college students are about twice as likely as students with college-educated parents to leave a 4-year college before their second year.[7]
- The gap between college enrollment among whites, blacks and Hispanic students has widened over the last 30 years:
    - In 2000, the enrollment gap between white and black students was 11 percentage points, up from only 5 percentage points in 1972.[8]
    - The enrollment gap between white and Hispanic students was 13 percentage points in 2000, up from a 5 percentage point gap in 1972.
- Financial barriers prevent 48 percent of college-qualified high school graduates from low-income families from attending a 4-year college; 22 percent will not attend any college at all. The percentages are similar for students in moderate-income families with household incomes less than $50,000.[9]

Academic preparation is also critical to ensuring that lower income students enroll and complete college degrees. But the growing disparity between enrollments and degree completion is occurring during a time when academic preparation for college has steadily risen among low-income students. More than half of high school seniors in households with incomes below $36,000 have completed college preparatory courses—up from just over one-third in 1987. Nonetheless, racial and class disparities continue to result in fewer low-income and students of color who are prepared for higher education.

The current access problem will be further strained as the largest generation since the Baby Boomers begins to age out of high school. The traditional college-age population is projected to grow by 16 percent between 2000 and 2015.[10] This generation will be more ethnically diverse, better prepared for college, and more likely to have financial need for college. By 2015, 80 percent of the college-age population will be non-white, and almost 50 percent will be Hispanic. Left unchecked, the disparities in educational opportunity could severely threaten our social cohesion, dividing the country into a well-educated, white minority and an under-educated non-white majority.

Impact on Economic Growth

Having fewer highly trained and educated workers dampens the economic productivity and growth of the Nation. It's estimated that narrowing the gap in the college participation rate would add $250 billion in gross domestic product and $85 billion in tax revenue.[11]

Ensuring that all qualified students can pursue education beyond high school is critical for maintaining the vitality of the American labor force. Nearly 60 percent of jobs today require some college.[12] Over the next decade, 6 of the 10 *fastest* growing occupations require an associate or bachelor's degree.[13] At the same time, job growth predictions also show that the largest growth in jobs over the next decade will be in the low-wage sector—those not requiring any post-secondary training.

Still other studies show that the looming retirement of the Baby Boomers will result in a major shortage of skilled workers.[14] The reason is simple: unlike the Boomers, who achieved higher levels of education than their parents and grandparents, successive generations have gotten about the same amount of education as their parents.[15] As the labor force is expected to grow far less in the next 20 years than it did in the last two decades, there may be a shortage of workers with at least some college education.[16]

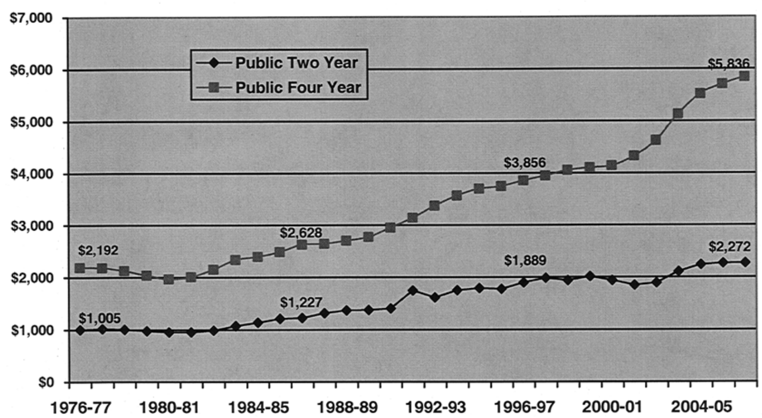
The current growth in outsourcing of service sector jobs may threaten the potential for young, educated workers to find jobs to match their skill set. At this time, however, the scope of the effects on economic growth and job creation caused by outsourcing is unclear and widely debated.

Whether or not the economy will generate enough jobs for college graduates is up for debate—and is something of a red herring in the debate over access to higher education. What's important—and what needs to be fixed—is who gets to compete for the best jobs in America. Currently, young adults from modest backgrounds, as well as young adults of color, are much less likely to enroll and complete degrees at 4-year universities. As a result, the playing field is far from level.

TRENDS IN COLLEGE COSTS

Over the last three decades, tuition at both 2- and 4-year public college and universities has been rising, with rapid increases in the last two decades. Since 1980, tuition at public 4-year universities has more than doubled, after adjusting for inflation (see Chart 1). In 2006, the average tuition at a public 4-year college was $5,836, up from $3,856 in 1996 and $2,628 in 1986 (2006 dollars). In the last 5 years alone, tuition has increased 35 percent, higher than any other 5-year increase from 1976 to the present.[17] Tuition at community colleges has risen, though not as steeply. In 2006, the cost of tuition at 2-year colleges was $2,272, up from $1,899 in 1996 and $1,227 in 1986.

Chart 1. Average Tuition and Fee Charges, 1976-2006 (2006 Dollars)



Source: College Board, Trends in College Pricing, 2006.

Tuition costs are just one aspect of the cost of attending college. Research has demonstrated that the most successful strategy for completing a college degree is full-time, on-campus study. Add in room and board charges for 4-year colleges, and the total cost of attending in 2006 was $12,796, up from $9,258 in 1996 and $7,528 in 1986.

There is much debate over why tuition prices have risen so dramatically in the last decade, and certainly several factors have contributed to the rise in college costs. One contributor which is relatively undisputed is the decline in State funding of higher education. Public universities receive the majority of their operational support from State appropriations, so when States flat-line or cut appropriations, public universities make up the deficit in operational revenue by raising tuition. Over the last two decades, the level of State support has been declining. In fact, per-pupil-spending is at a 25-year low. As a result, the percent of public higher education revenues from tuition has steadily increased, from 21.5 percent in 1981 to around 31 percent through the mid-1990s. After declining in the late 1990s, tuition revenues grew rapidly from 30 percent in 2001 to 36.7 percent in 2005.[18] While the absolute dollar amounts States spend on higher education have increased over the last decade, the increase has not kept pace with either inflation or enrollments, resulting in per-pupil spending at a historic low.

STUDENT LOAN DEBT AND TRENDS IN FEDERAL FINANCIAL AID

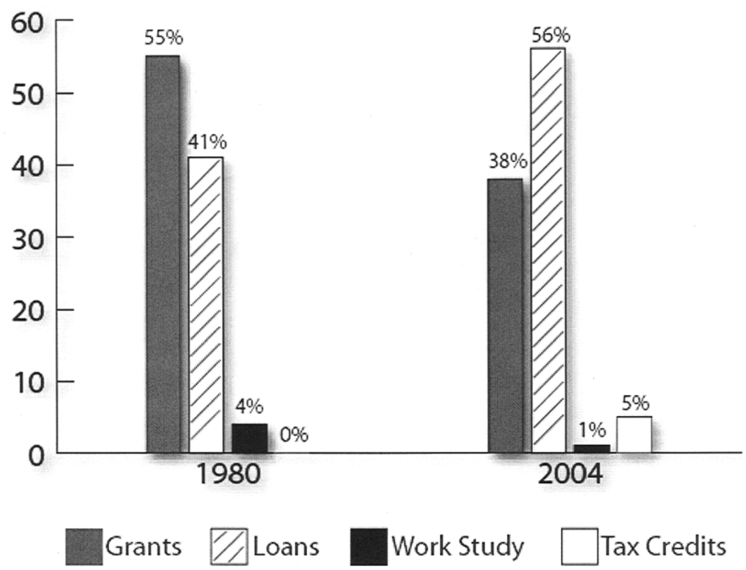
While increases in the published price of college have risen much faster than increases in the net price (what students actually pay after aid), student loan debt has more than doubled from $9,250 in 1993 to $19,200 in 2004.[19] The amount of student loan debt for those students graduating from public universities has also grown substantially, from $8,000 to $17,250.

Not only has the amount of debt among graduating students increased, the percentage of students who rely on student loans to finance their education has also risen. In 1993, less than half of all 4-year graduates had student loans; today, nearly two-thirds graduate with debt.

Low-income students, particularly those who receive Pell grants, are much more likely to have student debt than other students. Among Pell grant recipients who earned their degree in 2004, 88.5 percent had student loans, compared to just over half (51.7 percent) of non-Pell recipients.[20] Pell grant recipients also carried 12 percent higher debt, carrying on average $20,735 in student loan debt versus $18,420 for non-Pell recipients.

Our Nation's Federal financial aid system has become a debt-for-diploma system. Over the last two to three decades, the composition of Federal financial aid has shifted from a grant-based system to a debt-based system (see Chart 2). Of the $91 billion spent on Federal financial aid in school year 2003–4, only $19 billion was spent on grant aid, while loan-based aid comprised $65 billion.

Chart 2. Composition of Federal Financial Aid, 1980 and 2004.



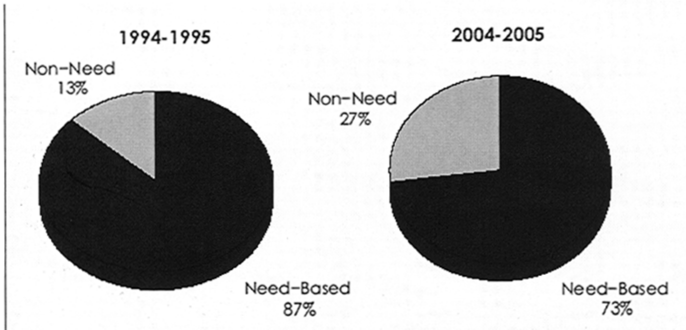
Source: College Board, Trends in Student Aid, 2004.

Not only does grant aid comprise a smaller share of the overall Federal financial aid pie, its purchasing power has declined precipitously, failing to keep pace with the cost of tuition and the surge in eligible students. As a result, what grant aid is available gets spread more thinly across a greater number of students.

Today the maximum Pell Grant award—the Nation's premier program for helping low-income students pay for college—covers about one-third of the costs of a 4-year college today. It covered nearly three-quarters in the 1970s.[21] But only 22 percent of Pell grant recipients received the maximum award of $4,050 in 2003.[22] The average award was $2,473, which covered about one-fifth of the costs of a 4-year public college.[23]

As the Federal Government was shifting resources away from need-based grant aid toward tax credits and debt-based aid, State governments and institutions were also shifting their aid dollars away from need-based aid (see Chart 3). Between 1994 and 2004, spending by the States on need-based scholarships for undergraduates increased by 95 percent, while spending on merit-based aid increased by 350 percent. The proportion of State grants awarded based on merit, rather than need, has risen from 13 percent to 27 percent during this period.[24] Similarly, universities have also begun using more of their financial aid resources to attract the best and brightest students—throwing increasingly percentages of aid dollars to students who could afford the cost of college without any aid. For example, in 1995, the average student from a family with an income below $20,000 received $836 in institutional grant aid, while students from families above $100,000 received an average of $239 in grant aid. In 2003, the average award to low-income students had increased 50 percent to $1,251 while the average award to students from families earning above $100,000 had grown 227 percent to $781.[25]

Chart 3. Composition of State-Based Aid, 1994-1995 and 2004-2005.



Source: National Association of State Student Grant and Aid Programs, 2005

PUTTING STUDENT LOAN DEBT IN CONTEXT

As the first generation to shoulder the responsibility of paying for college primarily by taking out loans, it's important to consider the larger economic context in which this new debt burden is unfolding. Some argue that the rise in student loan debt seems justified, or reasonable, given the economic benefit a college degree commands in the labor market. While it is true that someone with a bachelor's degree will earn approximately $1 million more in earnings over their lifetime than someone without a college degree, it is also true that the earnings for college graduates have remained flat for three decades (see table below). Earnings for young workers with "some college" have declined, with the typical young male worker with "some college," earning 17 percent less than the previous generation. It's important to remember that among this "some college" population are young adults who dropped out of college before completing their studies. One out of five borrowers drop out of college before finishing, leaving them with debt, but no diploma. The percentage of indebted non-completers is even higher among community college students, with one out of four borrowers dropping out without a degree.

The economic outcome of getting a bachelor degree has not risen for this generation; indeed the typical college grad is earning about the same as the previous generation. Rather, the college wage premium, as it is often called, is due to the precipitous decline in earnings power for workers with only high school degrees (see Table below).

	Males			Females		
	High School Diploma	Some College	Bachelor's Degree or Higher	High School Diploma	Some College	Bachelor's Degree or Higher
1974	$42,697	$44,257	$51,223	$25,913	$29,556	$35,674
1984	$36,773	$39,806	$46,775	$24,449	$28,263	$35,030
1994	$29,996	$33,650	$45,629	$22,604	$26,938	$37,363
2004	$30,400	$36,400	$50,700	$24,400	$28,800	$40,300

Source: National Center for Education Statistics, based on data from U.S. Department of Commerce, Bureau of the Census, Current Population Survey, March Supplement, 1972–2003.

In addition to stagnant or falling incomes, today's young adults face substantially higher costs for housing and health care than the previous generation experienced during their 20s and early 30s—yet median earnings have failed to grow to accommodate either the rise in basic costs, or to accommodate the new student loan debt burden.[26]

MAKING COLLEGE AFFORDABLE: THE CONTRACT FOR COLLEGE

The debt-for-diploma system is a failure.

The fundamental problem is rooted in the reality that our government no longer really helps people pay for college—it helps them go into debt for college. The question we need to be asking is not "how much student loan debt is reasonable," but "what is the best way to help students afford college?" Given the enrollment gaps by income and race, in addition to the serious social consequences reported by borrowers, there is solid evidence that a debt-based aid system is not the best method for making college affordable. This is especially true when it comes to achieving the goal of making college affordable to low-income young people, for whom grant aid is the difference between enrolling or foregoing college altogether.

The last two decades have greatly heightened the demand for a highly educated workforce—and the earnings differential between those with and without college degrees has widened substantially. A college degree has become what the high school diploma was 30 years ago—the surest pathway to the middle-class. Two years of post-secondary education is now considered the minimum level of education necessary for success in this economy. A worker with a bachelor's degree now earns about 70 percent more than a worker with only a high school diploma. Over a lifetime, that wage gap will add up to over $1,000,000. Those with "some college" earn more than those who only complete high school.

And yet, our financial aid system has become less responsive to the needs of young people, particularly those from low- to middle-income families. At a time when getting a college degree has become a near necessity for entry into the middle-class, our Nation's primary ladder of opportunity is broken.

In a Dēmos report, *Millions to the Middle: Three Strategies to Grow the Middle Class*, we proposed creating a new system called the *Contract for College*. The *Contract for College* is based on a simple premise: if you study hard and are academically ready for college, money will not be an obstacle course to fulfilling your potential. The *Contract* is similar to a set of proposals made by the bi-partisan National Commission on Responsibilities for Financing Post-Secondary Education, a body mandated by Congress in 1991 through legislation sponsored by Senator James Jeffords of Vermont, then Republican.[27] The Commission's recommendations, which were never implemented by Congress, were released in a final report in February 1993.

The *Contract* would unify the existing three strands of Federal financial aid—grants, loans and work-study—into a coherent, guaranteed financial aid package for students. The *Contract* would shift Federal financial aid funding toward more grant-aid for students. Students from households with incomes below $25,000 would be eligible for an annual grant to cover 75 percent of the costs of attending a 4-year university or $9,000, while a student from a household with income between $75,000 and $100,000 would be eligible for an annual grant to cover 40 percent of the costs, or $4,800. Part of the *Contract* for every student would include some amount of student loan aid and/or work-study requirement. But by providing grant aid for low- to middle-income students, it would end the five-figure student loan debt that stunts the progress of young adults. The table below provides an example of different *Contract for College* estimates based on family income.

The Contract for College

[Based on the average cost of annual enrollment at 4-year public colleges (approx. $12,000)]

Household Income below $25,000	Household Income between $25,000–$49,000	Household Income between $50,000–74,999	Household Income between $75,000–99,000	Household Income above $100,000
Grant to cover 75 percent of costs: $9,000.	Grant to cover 65 percent of costs: $7,800.	Grant to cover 55 percent of costs: $6,600.	Grant to cover 40 percent of costs: $4,800.	Unsubsidized loan: $10,000
Work-study: $1,500	Work-study: $1,500	Work-study: $1,500	Work-study: $1,500	
Subsidized loan: $1,500	Subsidized loan: $2,700	Subsidized loan: $3,900	Subsidized loan: $2,350 Unsubsidized loan: 2,350	

The model above is for illustrative purposes. An actual plan would include more gradual phase-outs between each successive income level.

An important component in designing the program would be to ensure that families have early knowledge of the financial resources available for their children to attend college. One of the weaknesses of the current financial aid system is that parents and students do not have adequate information about the amount of aid available to them until several months before enrollment. And aid amounts tend to change from year to year. The *Contract* could allow all households with students in the 8th grade and above to receive an estimate for aid based on the average cost of attendance at public 4-year institutions. For example, low-income families would be informed that they can receive a Pell grant that covers 75 percent of the cost of college, with subsidized loans and work-study to finance the rest.

In addition, the *Contract* would provide Federal student loans through the Direct Loan Program, ending the Federal Family Educational Loan Program (FFELP)—the government guaranteed loan program in which the Federal Government acts as an intermediary between students and banks, providing massive subsidies to ensure a guaranteed rate of return to lenders. Back in 1992, Congress tried to create an alternative plan to the subsidy-rich deal for private lenders. Instead of using private lenders, the government would put up the capital for student loans and disburse the money directly to the college. The program, called the Direct Loan Program, started as a pilot program in 1992 and was made an option for all colleges in 1993. Unlike federally guaranteed student loans, which cost taxpayers 7 cents on every dollar, the Direct Loan program costs less than 4 cents per dollar lent.[28] By switching all Federal loans to the Direct Loan Program, the Congressional Budget Office estimates that the Federal Government would save billions of dollars over 10 years due to the reduction in subsidies and administrative costs associated with the FFELP system.[29] Several pieces of legislation, with bipartisan sponsorship, have been introduced to encourage schools to participate in the Direct Loan Program.[30] Based on enrollment projections, including increases due to the availability of enhanced financial aid, the rudimentary estimate of the cost of the *Contract* is approximately $48 billion per year.[31] We estimate the cost of expanded Pell grants to be $39 billion, $9 billion for work-study, and some administrative costs associated with the direct loan program.

Existing revenue for the *Contract* includes current spending on Pell grants of $12.7 billion. We also propose eliminating the higher education tax credits which currently cost $5.9 billion and redirecting that money to the more need-based aid system of the *Contract*. Additional savings would be found by switching to the Direct Loan Program. In addition there are a variety of subsidies on existing loans in the FFELP system that if reduced could generate savings. For example, the special allowance payment to lenders on existing Stafford loans could be reduced by 50 basis points, as the President proposed in his budget, in addition to those on PLUS and consolidation loans. After reallocating money from existing spending on higher education programs, our cost estimates show an additional $30 billion will need to be raised.

In exchange for the Federal Government picking up more of the tab for college, States need to do their part to keep tuition prices under control. That means increasing, rather than decreasing, State appropriations to higher education. Over the last 5 years, States have consistently slashed their support for higher education as a way to deal with budget deficits. Back in the late 1990s, when States were flush with extra money, instead of stockpiling those revenues for a rainy day, most States enacted tax cuts. When the tech bubble burst, States were left with no reserves and the political non-starter option of raising taxes. State governments need to be more fiscally responsible about providing stable support for higher education, which is the biggest source of operating funds for State colleges.

Colleges too have an important role to play in keeping costs under check. The State university system in this Nation is the envy of the world. But far too often, State colleges are racing against each other to be the best in everything, instead of concentrating on developing core academic strengths. In any given State, public universities could save the system money by eliminating duplicative programs, coordinating research expertise and collaboratively reaching agreements for each university to home in on core academic fields.

CONCLUSION

Congress has recently enacted legislation that would lower the interest paid on certain Federal student loans. Last year, the House passed legislation that raised the maximum Pell grant. In addition, the President has proposed in his 2008 budget increasing the maximum amount of the Pell grant by $550, to a maximum of $4,600. However, neither of these reforms is adequate to address the scale of the problem that exists. In a country where higher education serves as the primary lever of economic and social mobility, the debt-for-diploma system represents a major failure. It's predicted that over the next decade more than 6 million college-ready students will fall through the cracks of the current financial aid system. Their aspirations and our future hinge on whether or not bold action is taken now to restore the ladder of opportunity, and to end the failing debt-for-diploma system.

ENDNOTES

[1] "College qualified" refers to the index of college qualification designed by the U.S. Department of Education's National Center for Education Statistics (NCES). The index evaluates high school seniors on cumulative academic coursework GPA, senior class rank, NELS test scores, and SAT and ACT college entrance examination scores. "Low-income families" refer to households with incomes below $25,000. "Moderate-income families" refer to households with incomes between $25,000 and $49,999.

[2] Postsecondary Education OPPORTUNITY, Unmet Financial Need, Student Work/Loan Burden and Net Price to Family for Dependent and Independent Undergraduate Students by Institutional Type/Control and Parental/Family Income Quartiles, 2004, October 2005.

[3] *Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity,* (Washington, DC.: Advisory Committee on Student Financial Aid Assistance, February 2001).

[4] Ibid.

[5] Ibid.

[6] Richard D. Kahlenberg, ed., *America's Untapped Resource: Low-Income Students in Higher Education* (New York: Century Foundation Press, 2004), p. 22.

[7] Nancy Hoffman. "College Credit in High School: Increasing College Attainment Rates for Underrepresented Students." *Change*, July/August 2003.

[8] Thomas R. Wolanin, ed. *Reauthorizing the Higher Education Act: Issues and Options*. (Washington, DC.: Institute for Higher Education Policy), 2003.

[9] *Empty Promises: The Myth of College Access in America* (Washington, DC.: Advisory Committee on Student Financial Assistance, June 2002).

[10] Ibid.

[11] *Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity.*

[12] Ibid.

[13] Bureau of Labor Statistics Employment Projections. February 2004.

[14] Anthony P. Carnevale and Donna M. Desrochers, *Standards for What? The Economic Roots of K–16 Reform.* Educational Testing Service, 2003.

[15] "Grow Fast Together. Or Grow Slowly Apart," The Aspen Institute, September 2002.

[16] Carnevale and Desrochers, *Standards for What? The Economic Roots of K–16 Reform.*

[17] The College Board, *Trends in College Pricing, 2006*.

[18] State Higher Education Executive Officers, State Higher Education Finance FY 2005.

[19] Project on Student Debt, "Quick Facts About Student Debt."

[20] Ibid.

[21] Gladieux, p. 29.

[22] "2003–2004 Federal Pell Grant Program End-of-Year Report." U.S. Department of Education, Office of Post-Secondary Education. Table 3A. Available online at *http://www.ed.gov/finaid/prof/resources/data/pell0304.pdf*.

[23] Ibid.

[24] Kati Haycock, "Promises Abandoned: How Policy Choices and Institutional Practices Restrict College Opportunities," The Education Trust. Available online at *http://www2.edtrust.org/NR/rdonlyres/B6772F1A–116D–4827–A326–F8CFAD33975A/0/PromiseAbandonedHigherEd.pdf*.

[25] Ibid.

[26] Tamara Draut, *Strapped: Why America's 20- and 30-Somethings Can't Get Ahead* (Doubleday: 2006).

[27] The Commission's final report *Making College Affordable Again* was released in February 1993. The report identified specific policy concerns, which led to the formulation of policy recommendations, including the Student's Total Education Package (STEP). The Commission's full report is available online at *http://www.ihep.org/Pubs/PDF/makingcollegeaffordable.pdf*.

[28] Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2008 Appendix*. Available online at *http://origin.www.gpoaccess.gov/usbudget/fy08/browse.html*.

[29] Committee on Education and the Workforce, "Bipartisan Student Loan Bill Would Boost Funding For College Scholarships by $12 Billion Without Costing Taxpayers a Dime, Says CBO," January 12, 2005. Available at *http://edworkforce.house.gov/democrats/releases/rel11205b.html*.

[30] See Sharkey, 2005. According to Sharkey, Rep. Thomas Petri (R-WI) and Rep. George Miller (D-CA) have introduced the Direct Loan Reward Act, which would es-

tablish incentives for colleges to switch to the Direct Loan program by offering to let them keep half of the savings for their use in financial aid programs. The bipartisan Student Aid Reward Act, introduced by Rep. Petri, Rep. Miller, Sen. Edward Kennedy (D-MA) and Sen. Gordon Smith (R-OR), asks the Secretary of Education to determine which student loan program is less expensive, and then provides additional scholarship money to schools that adopt the cheaper loan program.

[31] David Callahan, Tamara Draut and Javier Silva. *Millions to the Middle: Three Strategies to Grow the Middle Class.* (New York: Dēmos), 2004. Available at *http://www.demos-usa.org/pubs/millions*__web.pdf.

The CHAIRMAN. Thank you.

Dr. Oberg.

STATEMENT OF JON OBERG, PH.D., FORMER RESEARCHER, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC

Mr. OBERG. Thank you, Mr. Chairman, Senator Enzi, Senator Isakson. I'd like to request first that my written testimony be made a part of the record.

The CHAIRMAN. All of the written testimony will be part of the record.

Mr. OBERG. Thank you, Mr. Chairman. I'd also like to invite attention to my written testimony. It's far more than I say in 5 minutes here. I have 17 specific recommendations in the written testimony on the subject and I'd particularly like to invite attention to the footnotes in the testimony. Sometimes the footnotes are more interesting than the text and among these 17 recommendations, they don't all come from me and I have appropriately cited the authorities and the literature and so on, on which the recommendations are based. I'm negligent in a couple of cases, of not having that in there and let me say that here, on my recommendations, on the Fair Payment Awareness Program, which is a part of your bill, Mr. Chairman, S. 359 and also part of my recommendations. I'm indebted to the work of the Project on Student Debt for that.

Also, one of my recommendations deals with auctions, the potential auctions of student loans in order to bring more competitiveness into the system and for that, I'm indebted to the New America Foundation, which has been doing work on this.

My testimony was written about the first of January, about 6 weeks ago, when I first heard about this hearing coming up and I thought some of my ideas and some of those recommendations would be leading-edge at that time. I since discovered that they are much more mainstream than I had thought they would be. The idea of taking subsidies out of the loan programs and moving them to the grant programs of the Federal Government, which are under-funded and doing that through a process of entitlement spending, is an idea that is already embodied in your bill, Mr. Chairman and I was also very pleased to see that this is an idea that is in the President's budget as well.

Another idea I thought might be on the leading edge was to open up for public view, many of the processes that are evident in the selection of lenders, how student's financial aid packages are put together and so on and I find that, indeed, there is already a Student Loan Sunshine Act that has been introduced, bipartisan, bicameral. There is one in the House as well.

Let me, instead of going over those ideas, go over a couple of ideas where my recommendations are not already mainstream. I hope someday they will be but first let me say that when I was invited to testify, I asked your staff if I was expected to testify on the 9.5 guaranteed loan scandal. I was told that that was not the reason I was here particularly, because I had been the legislative liaison from the Department of Education for the reauthorization of the Higher Education Act in 1998 and then I might have views on some of the legislation that came out of that, such as the Europe Program, the VFAs, the Voluntary Flexible Agreements and other items but let me say a couple of quick words about the 9.5 problems.

As one of my attachments to my written testimony, I suggested back in 2003, that one solution to this would be simply for the Secretary to call the loans. I still think that is a good recommendation. That was put in as a bill last year by Senator Murray and Senator Kennedy and I commend that to you again and that is one of my recommendations.

There is also—I thought this might also be leading edge but I see that—and that is the recovery of the forgiveness of these illegal payments that has been done in the past month. I see the two House Republicans have already introduced or have a circulating letter asking the Secretary of Education to recall these funds, specifically about $322 million at Nelnet. My recommendation to the committee would be that I think it would be appropriate for your committee to advise the Department of Justice that before it acts on approving these illegal payment forgiveness's, that the Congress have an opportunity to exercise oversight on it.

Let me quickly turn to two items that are extremely important, I think. One is reform the student aid process. If anything is important in my testimony, it is reform of the process. Our process is a disgrace that is the Nelnet scandal times 100. One particular disgrace is what is called enrollment management. Enrollment management has been called by prominent researchers the ruin of American higher education. Let me simply say this. If you want the Pell increases to reduce student debt, you will have to end enrollment management as it is currently practiced.

Finally—my time has expired but let me say a couple points about private loans. The loan industry is restructuring around private loans. Congress needs to respond and shape how the industry will be restructured for the benefit of students.

Especially for Senator Enzi, I am a State and local person as he is. I believe that as this is restructured, we should have a role for the State agencies and that is embodied in one of my recommendations. So thank you, Mr. Chairman and Senator Enzi, for your time and I'd be happy to answer any questions.

[The prepared statement of Mr. Oberg follows:]

PREPARED STATEMENT OF JON H. OBERG, PH.D.

Mr. Chairman, members, thank you. This is a homecoming for me. Although I am here today as a political scientist and public finance researcher, I have worked many long hours in this building over three decades, first as staff to the Senate Budget Committee when it was led in a bipartisan manner by Senators Muskie and Bellmon, later as president of a college association working with Congress for the interests of institutions, and finally as legislative liaison for the Department of Education during the reauthorization of the Higher Education Act in 1998.

I am pleased to be back to recommend 17 changes in our student financial aid system. I will testify first on loans, then grants, then process, and lastly research.

LOANS

The HEA needs a major overhaul of its loan programs. Before I list reforms that would make the FFEL guaranteed loan program more efficient and effective, let me advance an idea whose time may have come: simply eliminating or phasing down the FFEL guarantee on new loans and moving the net savings to under-funded Federal grant programs.

Here's why:

- The Federal guaranteed student loan program, FFEL, costs Federal taxpayers billions of dollars annually, somewhat over $6 billion in 2007 according to OMB's estimates.[1] Moving net savings from ending FFEL guarantees to the Pell grant program, for example, could put Pell funding back relatively soon near the levels it started with when first fully implemented in the 1970s.
- The guaranteed loan program was not originally intended to draw heavily from the Federal treasury, but to fill a cash-flow gap for middle-income families not eligible for assistance under the Federal Government's loan and grant programs.[2] This is now 2007, but discussions surrounding the program sound like debates from more than three decades ago, when there was a lack of student access to capital. That time has long since passed.
- There are established alternatives. The Direct Loan program, by most credible accounts, is less costly as a vehicle to deliver Stafford and PLUS loans[3]; private loans for higher education, despite their troublesome rates, fees, and marketing practices, are now widely available and here to stay[4]; higher education tax benefits subsidize the higher education of the middle class.[5]
- Excess student loan debt burden is a real problem; students often must take out loans because of a paucity of grants for those with financial need. A logical response would be to move loan subsidy expenditures to support of grant programs. As important as it is to keep *loan interest rates* low for students, it is also important to consider *loan principal*; that is, how to keep principal down or eliminate it entirely for many students through better grant funding.
- The student loan industry that has grown up around the FFEL program has become the tail that wags the dog. Recent HEA reauthorizations have focused on loan industry subsidies to the neglect of the needs of students and families; Big Education now rivals Big Oil and Big Pharm in political contributions, with commensurate effects on the legislative process.[6]
- The loan industry's consulting services have abetted the shift of college and university resources away from the financially needy, with the unsurprising result of

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[1] Estimates may be on the low side; OMB assumes future legislated efficiencies. See *http://www.whitehouse.gov/omb/budget/fy2007/pdf/appendix/edu.pdf.*

[2] Lawrence E. Gladieux, "Federal Student Aid Policy: A History and Assessment," *http://www.ed.gov/offices/OPE/PPI/FinPostSecEd/gladieux.html*; Steven Brooks, "NASFAA History: 1966–1985," *http://www.nasfaa.org/Publications/2001/Nhistory66–85.html.*

[3] Increases in Direct Loan costs would marginally reduce the savings from eliminating FFEL, in the 5 percent to 10 percent range, based on OMB cost figures. (The Direct Loan program is less costly according to several government and independent studies, using various methods and assumptions. I am not aware of any studies to the contrary, save those paid for by the loan industry. Typically the latter use cash accounting or other methods the industry does not use on itself.)

[4] Private loans have been the fastest growing source of student aid in recent years and are now firmly established as components in many institutions' student financial aid packages. It is impractical for reasons of cost for the Federal Government to try to reduce the reliance on private loans by greatly increasing FFEL loan limits. A practical way for Congress to deal with private loan issues is to require disclosure and sunshine whenever such loans are mixed with Federal programs in students' financial aid packages. For the most part, private loan providers are the same as those that participate in the FFEL program. If no new FFEL loans were guaranteed, there would still be Federal outlays for many subsequent years to such loan holders for existing guaranteed loans. In this environment, these subsidies would be used to make private loan products (already highly profitable) more competitive, benefiting students rather than simply adding to bottom lines that make the student loan industry such a Wall Street favorite for high profits and low risks. The industry should not be underestimated in its ability to compete, if it must.

[5] At a December 2006, Senate Finance Committee hearing, Susan Dynarski proposed elimination of the Pell grant program and putting the savings into refundable tax benefits. This is the scale of thinking appropriate to the need for major changes in the way we try to provide college access, but it would make more sense to wind down the FFEL program, for which there are alternatives, and put the savings into Pell grants. Ironically, Congress established the guaranteed loan program in part as an alternative to tax benefit programs; having failed in that role, FFEL should be terminated, not Pell.

[6] Bethany McLean, "Dems: Make Student Loans Student Friendly," *Fortune*, November 13 2006.

higher loan burdens among low- and middle-income students and families. These industry-provided "enrollment management" services customarily countervail the mission of Federal programs to assist the financially needy populations.[7]

- There is a great deal of waste, abuse, and mismanagement[8] in the FFEL program, and perhaps outright corruption. The 9.5 percent guaranteed return scandal alone (in which several secondary markets in 2002–4 increased the volume of student loans paying a 9.5 percent guaranteed return, despite Congress's action in 1993 to phase out such loans) has cost Federal taxpayers untold sums, perhaps billions of dollars. In 2003, I wrote an internal memorandum to the Department of Education's chain of command identifying how the abuse of the 9.5 guarantee was being perpetrated. Had the Department acted on my analysis and recommendations at that time (or on those of GAO, a year later), billions of dollars of growth in these loans and subsequent payments of hundreds of millions to loan holders could have been avoided.[9] As matters now stand, the Secretary of Education has determined that this was an illegal scheme, but one secondary market, Nelnet, has been forgiven $322 million and an unknown number of others are also being forgiven, before they have even been audited. Inasmuch as this is now undergoing Department of Justice review, I recommend that the committee ask DOJ to delay any decisions until Congress has an oversight opportunity to review forgiveness of these illegal payments.

Here are nine reforms that, taken either independently or together, could phase down the FFEL program (my recommendation) or at least make the program more efficient:

Loan Reform 1: Gradually reduce the Federal guarantee on student loans until it is phased out. Congress should not beggar the Pell grant program for the sake of keeping an anachronistic guaranteed loan program afloat, the need for which existed 30 years ago but now is hardly compelling at a time when the student loan industry is several thousand lenders strong and is quickly restructuring around private loan programs that already receive significant State and Federal subsidies.[10]

Loan Reform 2: Use competitive bidding or auctions to set lender subsidies, rather than paying lenders a special allowance set by a lobbying process in Congress. One of the reasons the Direct Loan program is less costly than the FFEL program is *not* that it is run by the government, but that it is run by private industry through competitive bidding. Ironically, it is the government's hand in setting subsidies that makes the FFEL program an inefficient program compared to the one that is contracted out competitively to private industry. (Milton Friedman advocated the Direct

[7] See Kati Haycock, "Promise Abandoned: How Policy Choices and Institutional Practices Restrict College Opportunities," *The Education Trust*, August 2006. Economist Gordon Winston has said, "Enrollment managers are ruining American higher education." See Matthew Quirk, "The Best Class Money Can Buy," *The Atlantic*, November 2005. The ruinous practice singled out by both Haycock and Winston, "enrollment management," is marketed to institutions by a Sallie Mae subsidiary, Noel Levitz, to name one example. Professor Elizabeth Warren famously said on the CBS News Program *60 Minutes*, "It shouldn't be the case that Sallie Mae gets to play every hand at the poker table while the government is the one that keeps anteing up the money." But that's not the half of it, as the Sallie Mae business model plays every hand with families' tuition money as well: Sallie Mae subsidiary UPromise helps families save for higher education, while Sallie Mae subsidiary Noel Levitz consults with institutions about how to take the savings away.

[8] Office of Inspector General, U.S. Department of Education, "Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers," Final Audit Report, ED–OIG/A04E0009 September 2006.

[9] See Attachment A. In February 2004, I also shared this memorandum with the Government Accountability Office, which confirmed in its September 2004, report (GAO–04–1070) that the Department could have acted at any time to shut off 9.5 growth for a savings of billions of dollars. I likewise shared this and other analyses with the Office of Inspector General, which has subsequently found that the illegal payment scheme at Nelnet alone amounted to $1.2 billion.

[10] The student loan industry has at least the following subsidies available to its private (alternative) loans: (1) capital from State agencies; (2) non-dischargability of private student loans in bankruptcy; (3) bundling of private loans with federally guaranteed loans in securitization trusts; (4) powerful loan collection tools and collection of private loans prior to federally guaranteed loans; (5) student loan interest tax deductibility; (6) Federal administration of institutional eligibility; (7) potential revenue from sales of federally guaranteed loan assets. While these subsidies do not spread default risk in the manner of the current Federal guaranteed program, spreading private loan risk is not an insurmountable problem. Private student loans are typically guaranteed by a 3 percent to 8 percent fee capitalized to borrowers' loan balances, and some have third party insurers. Note that a 3 percent guarantee fee is the same as the 3 percent sum of fees in the Stafford loan program. Note also that industry leader Sallie Mae's spread for private loans in the last quarter of 2006 was 5.28 percent (and increasing over 2005), while the spread for FFEL loans was 1.20 percent, suggesting that private loans are very profitable and that lenders could assume more risk and could lower private loan fees if necessary to compete.

Loan program with income-contingent repayment; perhaps such loans should be called "Friedman Loans.") GAO has already done an extensive study of competitive bidding and auction mechanisms appropriate to the FFEL program.[11] For example, one of the market mechanisms identified in the GAO report was a competitive bid sale of contractor-originated student loans, with or without a guarantee. Since that report, loan holders such as the Illinois Student Assistance Commission have undertaken loan sales through competitive bidding, to the benefit of students. On the other hand, establishment of some market mechanisms could be complicated to enact, and are less desirable than simply phasing out FFEL.

Loan Reform 3: Reform the student loan guaranty agencies by building on the lessons of the Voluntary Flexible Agreement provisions of HEA 98. Previously, guaranty agencies actually had financial incentives to let borrowers go into default and then collect, rather than keeping the borrowers in repayment. The VFA provisions enabled the Department of Education to work with guaranty agencies to implement alternative payment systems so as to reverse these perverse incentives. Essential to this reform effort must be cost neutrality, if not cost savings, with the GAO report of 2002 on VFAs as a starting point.[12]

Loan Reform 4: Reinstate the former provisions of the HEA that guaranty agencies and secondary markets must operate under the explicit approval of their respective State governments and within the mission of the HEA. Some student loan entities exist in a nether land that, they have argued, allows them to avoid open meetings, ignore freedom of information requests, award their executives golden parachutes with "hush-money" clauses, and sell off assets for non-HEA purposes. Without reform, these agencies should not be permitted to issue tax-exempt bonds.

Loan Reform 5: Prohibit the conversion of more not-for-profit student loan entities to for-profit corporations. There is ample evidence that when conversion occurs, shareholder bottom lines override fidelity to the mission of the HEA. As the restructuring of the student loan industry develops around private loans, consider putting State not-for-profit agencies operating under close supervision of their governors and legislatures in an advantaged position so that they become the primary conduit through which private loans are subsidized and default risk is spread, rather than large for-profit corporations like Sallie Mae, which are more attuned to their stockholders than to students and families. Consider putting State agencies in a position of assisting colleges and universities in their respective States with choosing private lenders, perhaps by arranging competitive bids.

Loan Reform 6: Reallocate default risk among taxpayers and loan holders from its current 97 percent insurance to a figure more in line with financial services industry norms; end the unnecessary Exceptional Performer provisions, which now provide certain loan holders 99 percent insurance; and reduce the lender subsidy substantially. President Bush's 2008 budget proposes a 50-basis point reduction in the lender subsidy, an appropriate order of magnitude. President Bush's budget directs FFEL savings to increase need-based grants, consistent with the recommendations of this testimony.

Loan Reform 7: Establish loan collection conflict-of-interest rules to eliminate incentives for permitting loans to go into default and to eliminate collection of private loans before Federal guaranteed loans when the same borrower holds both. Adopt the proposals of The Project on Student Debt to limit excess borrower debt through payment limitations and better use of income contingent loans; these appear in S. 359 as the Fair Payment Assurance program.

Loan Reform 8: Require the Secretary of Education to contact borrowers and offer consolidation loans, including incentives as necessary, when in the interest of both borrowers and taxpayers.[13]

Loan Reform 9: There is a middle ground between winding down FFEL and FFEL reform: allow colleges and universities that choose the Direct Loan program to share in the resulting cost savings. The STAR proposal to establish such an effort is a good idea conceptually; critics have said it would result in excessive complexity as to how to calculate the savings and how to make the distributions. It is preferable, however, to the superficial FFEL reforms that have characterized recent HEA changes.

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[11] "Alternative Market Mechanisms for the Student Loan Program," GAO 02–84SP, December 18, 2001; *http://www.gao.gov/new.items/d0284sp.pdf*. Economist Robert Archibald has advocated institution-level competitive bids in an all-private loan system.

[12] "Federal Student Loans: Flexible Agreements with Guaranty Agencies Warrant Careful Evaluation," January 2002, GAO–02–254.

[13] The Secretary may already have this authority under Section 432 of the HEA, Legal Powers and Responsibilities, but it is not a requirement. The most obvious use of such authority would be to "call" billions of dollars of loans requiring taxpayers to guarantee loan holders a 9.5 percent return, for savings to taxpayers in the hundreds of millions.

GRANTS

The objective of making savings in the guaranteed loan program should be to enhance Federal need-based grant funding. This should take precedence over efforts to make borrowing more attractive.

Part of the problem with Federal grants (and I emphasize that it is only part of the problem) is that Federal grant funding has not kept up with the cost of college. The Federal Pell grant maximum in 1976 was $5,064, expressed in constant dollars, compared to the current maximum of $4,050. To have the same purchasing power today as 30 years ago at a typical 4-year public institution, the maximum now would have to be raised to approximately $6,400.[14]

The good news is that there seems to be a bipartisan consensus in Congress and much support throughout the country for a substantial increase in Pell grants.[15]

Pell grants alone cannot fulfill the purpose of the HEA. They must be accompanied by effective programs that provide students with good pre-college preparation and support while in college. The current Administration has been dead wrong in trying to kill TRIO and GEAR-UP programs in the past, and SEOG and LEAP in this year's budget. These programs need support, as do other similar State, local, and private efforts.

Federal grant programs such as SEOG, LEAP, and others serve good purposes and, while not beyond review, should not be distractions from more important issues, such as loan reform. Do not step on the beneficial, hard working ants of the HEA and claim to have slain a dragon. There is a big dragon out there, the student loan industry's exploitation of the FFEL program: as a citizen and taxpayer, I ask you to slay it, or at least tie it back in its cave.

PROCESS

The best intentions of loan reforms and increases in grant funding will be for naught unless there is reform of the student aid process. The current process is a national disgrace.

Here's why:

- Average students and families have a hard time filling out the FAFSA (Free Application for Federal Student Aid). Even CPAs have to turn to specialists to fill out these forms. Many families are turning to consultants and paying high fees just to complete the applications.[16]
- The information families struggle to put into the forms is often irrelevant to the type and amounts of aid students eventually receive, after they go through what is known as the aid packaging process. Many institutions will give students the package they want them to have, regardless of Federal need analysis or funding, because existing Federal rules do not have the teeth to ensure that the Federal funds are used for their intended purposes.[17]
- If students and families knew how their aid packages were put together, they would march on Washington. The reason they don't march is that the information is not available to them. How institutions package aid is often secretive, proprietary information.
- The prevailing packaging practice of the past few years among both public and private institutions has been to award more grant aid to better-prepared students at the expense of financially needy students, resulting in higher debt burdens for

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[14] The College Board, "Trends in Student Aid, 2006," p. 17. Note that in 1976 there was a cap of 50 percent of cost of attendance.

[15] Presumably the support is for aid to the lower-income. Congress should refocus Pell on the lower-income as it provides increases, inasmuch as under current formulas a substantial portion of the increases would expand the reach of Pell into the less needy population.

[16] *http://www.princetoninfo.com/200107/10704s04.html.*

[17] For example, the Federal funds may be used to decrease other grant aid in a student's aid package, as opposed to reducing the student's loan or work burden. One reason Pell grants have not been increased by Congress in recent years is criticism, especially from conservatives (but not limited to them) that Federal Pell increases do little good, for institutions use them as a reason to increase tuition. While there is not much evidence of this in terms of *list price* tuition, the same cannot be said for *net price* tuition. Many institutions raise net tuition by lowering their own grants and discounts for Pell and other outside scholarship recipients. (The procedure can be found on many institutions' web pages under "outside scholarship policy." The practice is sometimes rationalized as horizontal equity, but in the process it sacrifices vertical equity and Federal intent.) It is time to remove this impediment to Pell increases through process reforms, as discussed below.

lower income families. These practices include those known as "enrollment management" and "financial aid leveraging." [18]

• The student loan industry is the largest provider of enrollment management and financial aid leveraging services to institutions. Some providers sell software to institutions to circumvent the intent of Federal programs.[19]

• Institutions often steer students to "preferred" lenders rather than help them get the best loan terms, based not on what is good for the student, but in large part because of arrangements the institution has with the lender, which are often not divulged. Sometimes these arrangements have involved personal benefits for institutional employees.

• Private loans, sometimes decidedly disadvantageous for students, are increasingly put into aid packages without students' understanding of the distinction between guaranteed and private loans, especially when the lender is the same entity. My own research in 2003 at the Department of Education showed that substantial numbers of students with remaining Federal eligibility were nevertheless borrowing privately, on less favorable terms. Others have reported the same confusion, to the detriment of students.

Here are six process reforms that are necessary, individually or in combination, to make the HEA work for students and families:

Process Reform 1: Require that if any Federal aid is included in an aid package, the packaging process may not be considered confidential or proprietary, including preferred lender and private loan arrangements, enrollment management and financial aid leveraging techniques, and distributions of borrower benefits. Aid packaging and institutional arrangements with lenders should be, except as necessary to protect individual students' privacy, subject to the Freedom of Information Act and the Student Right to Know Act. Exposure to sunshine will change many practices for the better without further regulation, and illuminate practices that need regulation.[20] The bipartisan, bicameral Student Loan Sunshine Act is a good place to start. It may also be time to require that students who have remaining Federal loan eligibility be provided an informed consent process before a private loan is included in their aid package.

Process Reform 2: Vastly simplify the FAFSA application process, because much of the currently required application information is ultimately irrelevant to a student's total aid package. The best idea may be to gather most information from Federal tax returns for those who check this option on their tax forms. This would simultaneously deal with problems in the current application process, wherein families may be penalized for saving and especially saving in a child's name. We rely on the Internal Revenue code to determine how much we can afford to pay in Federal taxes; the tax system could likewise be used to determine how much we can afford to pay for higher education.

Process Reform 3: Adopt lessons learned from the Gates Millennium Scholarship program. The Gates Foundation has had more success than the Federal Government in using grants to lower loan burdens and to help students persist in college because of the conditions they set for institutions. (GMS requires a supplement-not-supplant condition on their grants to students.) [21]

Process Reform 4: Place on probation (for participation in Federal HEA Title IV programs) institutions that use enrollment management techniques to decrease low-

[18] Sam Kean, "Report Blames College Practices on Limiting Access of Minority and Low-Income Students," *The Chronicle of Higher Education*, September 1, 2006; Donald R. Hossler, "How Enrollment Management has Transformed—or Ruined—Higher Education," *The Chronicle of Higher Education*, April 30, 2004.

[19] For example, The College Board, a student loan provider in partnership with Sallie Mae and Citibank, has offered institutions aid-packaging software (FAST) to add back, to families' expected family contribution, the amounts they receive in Federal higher education tax benefits. The relationship between The College Board and Citibank is expressed in this December 19, 2006, Citibank press release: "The Citibank program allows the College Board to leverage the industry's leading education loan products . . . to enhance its market position as an education loan provider."

[20] "Cherry-picking" students for borrower benefits, for example.

[21] "Fattening up financial aid," *The Boston Globe*, December 30, 2006; Institute for Higher Education Policy, "Expanding Access and Opportunity: Impact of the Gates Millennium Scholars Program," June 2006.

income/first generation shares of enrollment.[22] Alternatively, if other reforms are not adopted, bypass some or all institutions in the awarding of Federal aid.[23]

Process Reform 5: In the Federal budget, move a desired Pell grant maximum by legislation from discretionary to entitlement, so as to cut loan entitlement expenditures in favor of grant support. This would be consistent with fiscal responsibility and a pay-as-you-go approach.

Process Reform 6: One process change that would slay several dragons with one blow would be to make Pell grants a matched entitlement; that is, when institutions put up a certain level of match from their own funds, the Federal Government would consider the Pell grant an entitlement (up to a set maximum).[24] That change would facilitate moving loan entitlement savings to grants but also give incentives to institutions such that they would, on their own, work with the Federal Government in assisting the financially needy. This would help to reverse the current trend, which has been for institutions to shift money away from the low income faster than Federal and State Governments have been able to add it.

The importance of process reforms is essential. I would go so far as to say that not one single dollar of additional Pell grants should be spent until there is process reform to ensure that it will aid students and families as it is intended to do. The Federal Government must take the lead in getting Federal, State, and institutional governments to work together, rather than countervailing each other, in the national cause of improving college access and affordability. Process reform is crucial to restoring the moral authority of institutions to request increases in Pell grants, which authority has eroded to virtually nothing as institutions have moved their own funds away from the low income while hypocritically asking Federal taxpayers to pick up the bill.[25] Many institutions would welcome Federal leadership to get away from the "alms race" without disarming unilaterally.

FEDERAL RESEARCH

As a recent Federal researcher, I would be remiss if I did not make recommendations about needed research reforms in Federal HEA related research.

Here's why reforms are needed:

- In terms of the Higher Education Act, the U.S. Department of Education has no research or evaluation effort worthy of the name. It does minimal HEA research and evaluation, despite the importance of the HEA to the future of the country and the fact that approximately half of the Department's funding and personnel are involved in HEA programs. At the Department's Institute of Education Sciences, the National Center for Education Evaluation (NCEE) does no evaluation of the major grant and loan programs of the HEA; the National Center for Education Research (NCER) has no researchers who do research[26]; and the National Center for Education Statistics (NCES) compiles statistics but its reports fall well short of the scientific research standards set for the Department under the Education Sciences Reform Act of 2002.[27]

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[22] Suggestion comes from Tom Mortenson, "Five Questions for Enrollment Management," *Postsecondary Education Opportunity*, December 4, 2005. *http://postsecondaryopportunity.blogspot.com/2005_12_01_postsecondaryopportunity_archive.html*.

[23] Suggestion comes from Richard Vedder, "The Administration's Pell Grant Initiative," February 1, 2007. *http://collegeaffordability.blogspot.com/2007/02/administrations-pell-grant-initiative.html*.

[24] Variations on matching have been advance by others, most prominently by Michael McPherson and Owen Schapiro in several books and articles.

[25] See Donald E. Heller, "Elephant in the Student Aid Office," *InsideHigherEd*, September 25, 2006, reproduced here as Attachment B.

[26] See Attachment C, the e-mail response to Attachment A, which identified waste and abuse in the FFEL student loan program. It is highly unlikely IES will be able to attract qualified researchers to fill research positions if the duties involve only research administration paperwork, as opposed to research itself. Just because researchers may turn up inconvenient findings that conflict with the policies of the administration, or potentially embarrass it, is not sufficient reason to prohibit research. In fact, IES was intended by Congress to be the office at the Department where research is insulated from such considerations. (As is often the case, the attempt to cover up the evidence or silence the messenger may turn out to be more damaging than dealing forthrightly with the problem. Likewise, the screening of academic researchers through background investigations raises the specter of allowing information access only to those who can be trusted in their research conclusions. On background investigations at the Department, see Jonathan D. Glater, "Critics Question Education Department's Screening," *The New York Times*, February 11, 2007.)

[27] GAO found no student aid research works produced or contracted out by the Department that met standards for scientific rigor. See "Student Aid and Tax Benefits: Better Research and Guidance Will Facilitate Comparison of Effectiveness and Student Use," GAO–02–751, Sep-

• The postsecondary databases compiled by NCES at the Department of Education are outdated inasmuch as they do not adequately permit integration of student enrollment, academic preparation, and financial aid information.

• Many NCES descriptive reports do not present information in a manner useful to policy analysis and legislative oversight. Take the debate over college affordability, for example: despite the obvious relevance of net institutional tuition charges (that is, tuition list price minus institutional grants or discounts), NCES does not present such information in its reports. Nor does NCES typically break down family income statistics by race and ethnicity, despite their obvious relevance to the debate over affirmative action.

• The Department of Education has asked for an expensive and perhaps invasive "unit record" data system, despite having a great deal of information that it has not fully explored and researched. Although it has wisely backed away from its most extreme "unit record" version, there is still room to improve the proposal.

The following two research reforms would go a long way toward addressing the need for adequate research to support the HEA and its programs:

Research Reform 1: Require the Department of Education to publish pricing information on its College Opportunities On Line (COOL) Web site in a manner that facilitates student and family comparison of institutional net prices, including information in terms of family income, race and ethnicity. Require similar breakdowns in all descriptive reports dealing with college affordability and distributions of student financial aid.[28]

Research Reform 2: Require an updating of current higher education databases; require presentations of information in terms relevant to policy debates and legislative oversight; require evaluations of major HEA programs, and restore the conduct of research to the job descriptions of research personnel.

Thank you for the opportunity to testify. I think it is commendable that your committee has found time to hear from an individual who is a citizen, taxpayer, and parent, not representing any group with a special interest in the HEA. I would be pleased to answer questions and to work further with both sides of the aisle on putting these recommendations and others into legislative language and ultimately into effect.

ATTACHMENT A

November 21, 2003.

To: DEPARTMENT OF EDUCATION
Through: IES CHAIN OF COMMAND

SUBJECT: ELIMINATING WASTE IN DEPARTMENT OF EDUCATION STUDENT LOAN PROGRAMS

In the course of doing research into postsecondary education finance, I have come across what appears to be significant Federal waste. I estimate it amounts to about $30,000 per day, perhaps more. In essence, the Department of Education is expanding the base amount of Stafford loans on which a return of 9.5 percent—well above market—is guaranteed to certain loan holders, when there is no reason to do so.

Knowing that ED makes "special allowance payments" to student loan holders, in early 2003 I began to look into how a certain category of these payments, the so-called "9.5 percent floor SAPs," are being distributed. By law, if the payments are excessive, they must either be returned to Treasury under arbitrage rules or distributed for eligible purposes, such as student benefits. I endeavored to determine how the payments might be benefiting students by demographic categories such as family income, race/ethnicity, and type of institution.

I expected to find increases in the amounts of the payments, given that students are paying historically low interest rates for Stafford loans and therefore ED must pay high spreads (as much as 6.68 percent) in order to provide the loan holders a 9.5 percent return. However, I expected to find declines in the base amount of the outstanding loans, inasmuch as Congress repealed the authority for the program in 1993. What I found instead was an increase in the amounts outstanding, some of

tember 2002, pp. 41, 46, 47. Several NCES studies have been criticized by academic researchers for reaching causal conclusions without using causal methodologies.

[28] See Attachment D for an example of the student financial aid information available to prospective students on the COOL web site. Note that it is not possible to tell where institutional grants (the largest source of aid) are going in terms of family income, race, or ethnicity. Families therefore are at a disadvantage to know what to expect in their students' financial aid packages, and the public-at-large is kept in the dark as to how the financial aid process works and who benefits.

it rapid in the past 2 years, with little legal authority for the increase beyond a trade association's interpretation of a 1996 ED letter. I found no effort at ED or Treasury to evaluate the program under the requirements of the Government Performance and Reporting Act (GPRA), and I have little reason to think the payments are systematically distributed in any way that would result in expanding postsecondary opportunity. The payments go to both for-profit and not-for-profit entities.

The Secretary of Education could stop the increases in the base amount immediately. The increases are resulting from transfers of the 9.5 percent floor loans to taxable bond issues and refinancing of the original tax-exempt issues. Here is how one loan holder described the process:

> According to EFC, ED provided guidance in a March 1996 Dear Colleague letter that 9.5 percent floor loans retain the floor . . . even after they are transferred from a relevant [tax exempt] bond issue. As far as the balance of loans earning the 9.5 percent floor, as long as the [original tax exempt] bond issues remain open, the recycling provisions of the indentures results in increases in the loans receiving the 9.5 percent floor.

Some loan holders, however, suspect that this process is questionable. A July 2003, Nelnet IPO acknowledged that as a recipient, it questioned whether it is entitled to the funds. (IPOs must provide full disclosure to potential stockholders.)

> A portion of our FFELP loan portfolio, with an outstanding balance of $925.2 million as of June 30, 2003, is comprised of loans, which were previously financed with tax-exempt obligations issued prior to October 1, 1993. Based upon provisions of the Higher Education Act and related interpretations by the DOE, we believe that we may be entitled to receive special allowance payments on these loans providing us with a 9.5 percent minimum rate of return. To date, we have not recognized interest income generated by these loans based on the 9.5 percent minimum rate of return. We have asked the DOE to confirm that we are allowed to recognize the income based on the 9.5 percent minimum rate of return. We have deferred recognition of this excess interest income pending satisfactory resolution of this issue. As of June 30, 2003, the amount of excess interest income deferred totaled approximately $5.9 million. Since we did not refinance loans with the aforementioned tax-exempt obligations until 2003, all of this deferred income was recorded this year.

Recently, I had a personal conversation with a different recipient, who advised,

> The 9.5 percent guarantee can't be justified. But if we are allowed to enlarge the base, we'd be fools not to exploit it for all it's worth.

As to the amounts involved, last year the 9.5 percent floor SAPs cost $432 million. I estimate that approximately $70 million of that was due to net growth in the amounts outstanding since repeal of the underlying authority. For the current year, I believe a reasonable estimate of the cost of more growth could be an additional $20 million to $30 million, depending on how much the procedure is exploited. (One loan holder expanded amounts outstanding from $900 million in 2002 to $1.3 billion in 2003.) Even if the cost of the growth is only $12 million higher for 2004 (a conservative estimate) that is $1 million per month that could be saved were the Secretary of Education to act now to cut off the base growth of these payments. That is in excess of $30,000 per day.

The Secretary could issue a Dear Partner/Colleague letter that would clarify the 1996 letter, to disallow future increases in the amounts of 9.5 percent floor loans outstanding. This would be consistent with the 1993 law (OBRA 1993) that repealed the authority for new issues.

The above discussion deals only with the growth of the amounts of the 9.5 percent floor loans outstanding, not with the existing base of approximately $13 billion. The existing loans could be dealt with as well, however, were the Secretary to ask Congress for authority to contact student borrowers and offer to replace such loans with loans on which the borrowers would pay less interest. This would essentially be the same as calling the loans, a routine business practice. Replacement loans would be issued through direct loan consolidation, on which ED pays no SAPs. Such a procedure would result in both a savings to student borrowers and to taxpayers, perhaps up to $3 billion over the next decade.

Any or all of these savings could be used to increase funding for postsecondary programs that have more potential for increasing postsecondary opportunity to fulfill ED's mission.

JON H. OBERG,
IES/NCER.

ATTACHMENT B

THE ELEPHANT IN THE STUDENT AID OFFICE

(By Donald E. Heller)*

Secretary of Education Margaret Spellings' *Commission on the Future of Higher Education* recently released its report titled "A Test of Leadership: Charting the Future of U.S. Higher Education." The report contains a series of recommendations built on a year of deliberation by its 19 members. First and foremost is the recommendation that "the U.S. commit to an unprecedented effort to expand higher education access and success by improving student preparation and persistence, addressing non-academic barriers and providing significant increases in aid to low-income students.

Last week, in an effort to get out ahead of the momentum that is already building for the report and its recommendations, the American Council on Education and the other organizations that make up the "big six" higher education lobbying groups in Washington issued an eight-page letter to their members.

This document, "*Addressing the Challenges Facing American Undergraduate Education*," describes seven "issues and actions" that the organizations expect will result from the issuance of the Spellings commission's report. The first of these actions, echoing the commission's first recommendation, is "Expanding college access to low-income and minority students."

According to the six organizations, "The single most effective step to boost college participation of low-income and minority students is to increase substantially the value of Pell grants." Pell grants, the centerpiece of the Federal Government's efforts to reduce college cost barriers for low- and moderate-income students, is indeed a critical part of the Nation's financial aid system.

The letter supports the commission's recommendation to increase the value of the average Pell award form 43 percent of the average in-state tuition at a public 4-year institution to 70 percent within 5 years. This is a noble goal, and having the support of the six lobbying groups is critical in helping to persuade Congress and the Bush administration to support it also. ACE's own calculations demonstrate that such an effort could require almost doubling the current $13 billion budget of the Pell grant program.

The letter also encourages colleges and universities to find ways to control the growth of costs, again echoing a major theme of the Spellings commission. And it encourages the institutions to do a better job providing to students and parents clearer and more accurate information about the true "net price" of college, after taking into account financial aid.

But in all the discussion in the letter about making college more affordable, these organizations ignore the elephant in the room: how colleges and universities spend their own institutional financial aid funds. While an increase in the value of Pell grants will certainly help achieve the objective of expanding postsecondary opportunity for low-income students, the goal could be promoted much more quickly and effectively through the reform of institutional financial aid policies.

In *a study I conducted* earlier this year for the Wisconsin Center for the Advancement of Postsecondary Education, I examined the distribution of grant awards to undergraduate students. Using data from the National Postsecondary Student Aid Study, a nationally representative sample of students from the 2003–4 academic year, I looked at what many label "traditional college students"—those who are still dependents of their parents and attended a single college full-time that year.

What I found was while colleges and universities provided just over $4 billion in Federal grants and $3 billion in State grants to these students, they provided more than $10 billion in grants from their own resources. The Nation's colleges and universities should be applauded for the effort they make in helping to lower the cost of college by partnering with the Federal and State Governments to award grants from institutional resources.

But not all grants are alike. My study found that while 97 percent of all Federal grant dollars and 75 percent of all State grant dollars awarded to these students went to those whose parents' income was below the national median, only 47 percent of all institutional grants were targeted to this same population of students. Over half of the grants awarded by institutions, or $5.5 billion, was awarded to students without any consideration of their or their parents' financial need.

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* Donald E. Heller is associate professor of education and senior research associate in the Center for the Study of Higher Education at Pennsylvania State University in University Park.

The original story and user comments can be viewed online at *http://insidehighered.com/views/2006/09/25/heller.*

This is in contrast to Pell Grants, which are very highly targeted at needy students, and three-quarters of State grants, which also use financial need as the primary criterion for determining eligibility. The lack of means-testing in the awarding of over half the institutional grants, along with broader definitions of "need," results in a very different distribution of awards as compared to means-tested Federal and State grant programs.

There has been much written in the Nation about the necessity of helping middle-income students find ways to help pay for college, especially since many of them come from families that are above the eligibility cutoff for Federal or State need-based grants. Many institutions have indicated that they are filling that objective through their own institutional grant programs. And while many of these grants do go to students of modest means, the truth is that many go to students who come from families with incomes well above a level that most of us would describe as "modest."

For example, in 2003–4, institutions awarded more than $2 billion in grant aid to dependent students from families with incomes in excess of $108,000, or approximately twice the median family income of all dependent students in the Nation that year. While some may believe that these families deserve help in paying for college, it is difficult to make the argument that this should be a priority in light of the Spellings commission's declaration that its members "are especially troubled by gaps in college access for low-income Americans." One is hard-pressed to argue that giving $2 billion in grants to students from these upper-income families helps to address the commission's concerns.

What is particularly troubling is that the letter from ACE and its partner organizations never once lays even a portion of the responsibility for helping lower-income students afford college at the doorstep of the financial aid policies of their member institutions. There is language in the letter, of course, about expanding Pell Grants, and about other "efforts" and "goals" of institutions to improve access for poor students. There is also the announcement of another public service campaign called "Know How To Go" targeted at low-income students (raise your hand if you remember ACE's "College is Possible" campaign, which was launched in 1997 and sounds awfully similar to "Know How To Go").

But never does the letter recommend that these institutions conduct an evaluation of their own financial aid programs to determine whether they are working in consort with the goal of expanding access for underserved populations, or whether they are simply rewarding wealthier students who have had many social, financial, and academic advantages in the years before they went to college.

Rather than focusing solely on public service campaigns, cost-cutting efforts, and new ways of explaining the difference between "sticker price" and "net price," colleges and universities would be much better off by simply taking this $2 billion and putting it in the hands of low- and moderate-income students. This decision could be made tomorrow, requires no action on the part of the Federal Government, and would have an immediate impact on the college participation of these students.

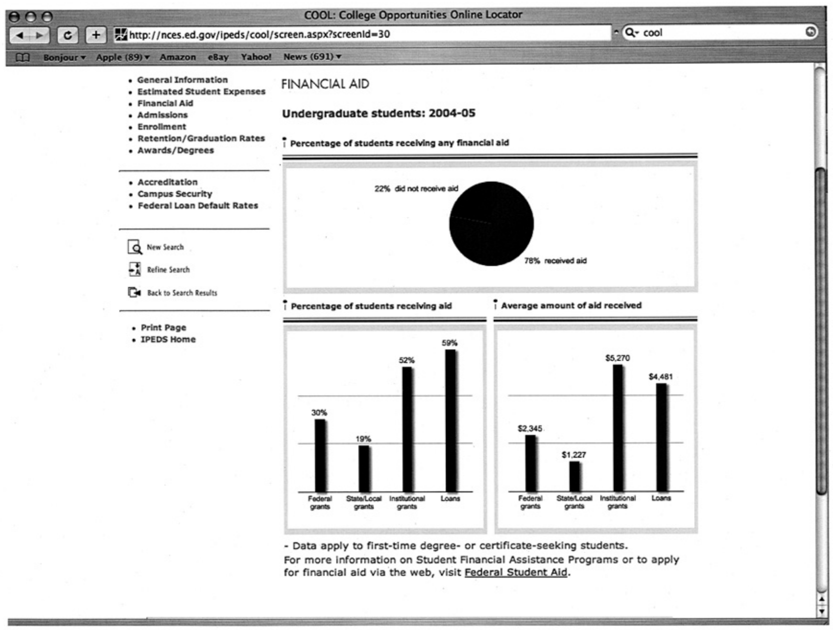
The American Council on Education and the other higher education organizations in Washington should be lauded for their attempts to be proactive in supporting the recommendation of the Spellings commission to improve college access for low-income students. But before the organizations and their member institutions ramp up their external public relations and lobbying efforts, they should look inward at their own practices.

Reforming institutional policies so that all financial aid resources are focused on students who truly need them to be able to afford college—rather than being awarded to students who would attend college anyway—is an important first step.

ATTACHMENT C

From: WHITEHURST, GROVER
Sent: WEDNESDAY, NOVEMBER 26, 2003 2:24 PM
To: OBERG, JON
SUBJECT: RE: Two Items of Concern

JON: I will forward your letters to appropriate people. As soon as acting associate commissioner Wiatroski is in place and has his feet under him, I want you and he to address your EDPAS agreement, with specific attention to your job responsibilities. NCER does not have an intramural program of research on postsecondary education finance, so whatever you have been doing in that arena will need to be justified and approved under a concept clearance if it is to continue. In the 18 months you have remaining, I will expect your time and talents to be directed primarily to our business of conceptualizing, competing, and monitoring research grants.



The CHAIRMAN. Thank you.
Dr. Baum.

STATEMENT OF SANDY BAUM, PH.D., SENIOR POLICY ANALYST, THE COLLEGE BOARD AND PROFESSOR OF ECONOMICS, SKIDMORE COLLEGE, SARATOGA SPRINGS, NY

Ms. BAUM. Thank you Chairman Kennedy and Ranking Member Enzi, for giving me the opportunity to be here and talk with you about issues of college access and affordability.

The Federal student aid programs make a vital difference in the lives of many students and Congress is to be commended for the recent increase in the Pell grant maximum, which was long overdue. However, significant gaps remain in college access and affordability in this country and some of our policies could definitely be made more equitable and more efficient in order to improve the opportunities faced by students at the bottom end of the income distribution.

The issue is obviously two-sided. Rising prices are a problem as is the shortage of funds to pay those prices. I'm only going to say a couple of words about the tuition side of the equation. Some of these have been mentioned already. First, rising prices are not a new phenomenon. Public college tuition has been rising more rapidly, particularly at 4-year colleges in recent years than it has historically but this is just not a new story.

Second, we should definitely be focusing on the net price that students and parents actually pay, after taking grant aid and tax benefits into consideration. It's the net price of college that determines affordability. The story about GW that we heard before is the story about sticker prices and unfortunately, it's all very complicated and difficult to get students and families to understand.

To understand why prices are rising, I address that issue in my written testimony. Federal student aid is not the explanation for why prices are rising. So what we can do in order to help students is primarily help them with student aid. We should not be trying to regulate prices. We should be urging colleges and universities to do better at containing the costs of providing quality higher education for students and encouraging States to maintain reliable funding for public institutions.

The market does work, to a reasonable extent, in higher education. Students and families are already voting with their feet and moving to attend institutions with lower prices and lower net prices. But student aid is the best vehicle for the Federal Government to address college affordability.

Again, there is a lot of detail in my written testimony but what I think is particularly important is that the principles be kept in mind when designing student aid policies. We have a hodge-podge of programs now and they are not all rooted in principles that are valid for designing the best student aid programs. We should have adequate funding but we also need simple programs. We need predictable programs. We need well-coordinated programs and we need programs that are well-targeted. Many of our dollars now are targeted at students who could easily afford to go to college without subsidy. These programs are nice for them but they're not necessarily changing their behavior. We need to help students in the bottom half of the income distribution.

We do need to simplify. We need to simplify the Federal application form. We need to make aid predictable. When families with children fill out their tax forms and they could get a notice of what kind of Pell grant aid they would be eligible for if they were to apply, under current circumstances. We should be able to have a table that tells you, given your family size and your income, what your Pell eligibility will be.

We should also be helping families early on to expect that they will be able to pay for college. Aid should be predictable. We should have subsidized savings programs for students from low-income families when they're young so that their expectations will be higher about whether the money will be there when they are ready for college.

The Federal Government should also be using some of its limited dollars, more of its limited dollars, to provide incentives for other partners in the higher education financing process to direct their funds towards students with high need. Some of the proposals by Senator Reed and Senator Enzi, to expand the current LEAP program, provide incentives for States and institutions to provide need-based aid and mentoring programs are moves in a good direction on this front.

The Federal methodology for determining who gets aid is flawed. Probably the biggest flaw in the current system is the work penalty, aside from the complication of the system. Right now, if students work excessively, in order to fund their own educations, we penalize them by taking away their eligibility for Federal aid. That's a problem.

Then the student debt question, which has already been addressed here but I want to make some more comments about it. First, I agree with many of the comments that have been made but I disagree with others. The typical student is not the problem. The typical amount of debt with which a student graduates with a Bachelor's degree of about $20,000 is fine for the typical graduate. The payoff to a college education is very high. The problem is, that a growing minority of students do face very real difficulty and the fact that the median student doesn't have a problem does not diminish the problems with those students. We need to target our improvements in the student loan system. We need to subsidize the students who have trouble repaying their debts. So the income contingent repayment plans by Senators Clinton and Kennedy are really good moves in this direction, as are the improvements in the hardship provisions that have been proposed by the Project on Student Debt and by Senator Kennedy.

And the private loan issue is huge. No matter what we do to help students pay off their Federal loans, 20 percent of education debt now comes through private markets. We have to do something about that. We have to subsidize students more through a simpler process, both based on their financial circumstances before college and based on their financial circumstances while they are paying off their student debt. Thank you.

[The prepared statement of Ms. Baum follows:]

PREPARED STATEMENT OF SANDY BAUM, PH.D.

I would like to thank Senator Kennedy, Senator Enzi, and the members of the Health, Education, Labor, and Pensions Committee for giving me the opportunity to discuss the issues of college access and affordability and the Reauthorization of the Higher Education Act. The Federal Government's efforts to increase college access and affordability are critical to the Nation's future. Existing student aid policies have contributed to rising college participation levels and have eased the financial burden higher education imposes on students and families across the Nation. Recent moves to increase the maximum Pell Grant are particularly encouraging, indicating a renewed willingness on the part of lawmakers to address the persistent problems of access to higher education in our society. Improving the financing mechanisms for students can also make a very real difference in promoting educational opportunity.

THE IMPORTANCE OF FEDERAL STUDENT AID

In 1974, fewer than half of U.S. high school graduates enrolled immediately in college. The increase in that proportion to two-thirds over the past 30 years [1] could not have occurred without the significant contribution of Federal student aid programs. Along with the efforts of both States and institutions in providing financial assistance to students, Pell Grants, Stafford Loans, and other Federal aid programs have opened the door to financial and personal success for millions of Americans.

Yet unacceptable gaps in college enrollment rates, and even larger gaps in college completion rates, persist between students from privileged backgrounds and those from low- and moderate-income families with similar academic qualifications. These gaps are not only inequitable, leading to the perpetuation of inequality from generation to generation; they also represent significant inefficiency for the U.S. economy. As great as the private benefits to higher education are, the social benefits are even higher. Society benefits in both financial and non-financial ways from increased educational attainment among the population. College-educated adults are our most active civic participants. Higher levels of educational attainment also reduce dependence on public income support programs, generate higher tax revenues, and lead to

[1] National Center for Education Statistics, *Digest of Education Statistics 2005*, Table 181.

increased productivity and higher wages for all, including those who do not themselves have college degrees.[2]

Financial barriers provide only a partial explanation for the gaps in educational attainment across socioeconomic groups. The problems we face are also rooted in academic preparation, aspirations, and expectations. Efforts to increase affordability, both through moderating price increases and through providing student aid, cannot solve all of the problems in this area. However, it is clear that finances play an important role and that many students from low- and moderate-income backgrounds lack the financial wherewithal to enroll and succeed in college. More equitable and efficient policies with more generous funding have the potential to significantly reduce the barriers to educational attainment facing too many Americans today.

Congress now has the opportunity to make significant improvements to the current system of higher education finance. A number of bills sponsored by members of this committee embody ideas that, if implemented, would represent major improvements in college access and affordability. Prominent among these are Senator Kennedy's Student Debt Relief Act, Senator Clinton's Student Borrower Bill of Rights, and Senator Reed's and Senator Enzi's proposals for revitalizing and expanding LEAP to increase the effectiveness of Federal matching funds for need-based grant aid from States, institutions, and other entities. The HEA Reauthorization is a particularly important opportunity for improving the lives of our students and the future promise of the U.S. economy.

Financial barriers to college access and success result both from the high and rising price of college and from the inadequacy of the student aid funds available to low- and moderate-income students. I will address these two issues in turn.

THE PRICE OF COLLEGE

Rising College Tuition has a Long History

Tuition increases make headlines. The focus is almost always on published tuition and fee levels and usually on the highest prices and the largest increases. While tuition and fees do consistently rise more rapidly than the Consumer Price Index, this information is hardly sufficient to evaluate the prices students face. The 51 percent increase in the inflation-adjusted average tuition and fees at public 4-year colleges and universities over the past decade was very high by historical standards, and this growth is clearly not sustainable in the long run. However, the much smaller rates of increase in tuition and fees at private 4-year colleges (where dollar increases are, of course, larger than in the public sector), and particularly at 2-year public colleges, were actually smaller than the increases of recent decades. In other words, rapidly rising college prices are not a new phenomenon.[3]

Variations in Tuition

The average prices that are reported by the College Board each year, as well as by the Department of Education, hide considerable variation not only across sectors, but also across States and geographical regions, and even within these categories. Students have many options. Forty-two percent of full-time 4-year college students—and 58 percent of those in the public sector—are enrolled in institutions that charge less than $6,000 a year. Twenty-five percent of full-time college students, and a significantly larger proportion of part-time students, are enrolled in 2-year public colleges, where average tuition and fees are about $2,300.[4]

Non-Tuition Expenses

Although the sticker price exaggerates the amount the majority of students pay for college, the reality is that the cost to students participating in higher education is significantly higher than just tuition and fees. Room, board, and other costs of attendance contribute to the affordability problem. Even if a student has a Pell Grant that covers the full tuition and fee charges at a 2-year public college, she/he must cover living expenses as well. Tuition expenses constitute less than 20 percent of the total out-of-pocket cost for students at community colleges who cannot live with their parents. Moreover, it is foregone wages that constitute the largest cost for many college students. Successful participation in higher education usually involves diminished labor force participation. Particularly for students with family responsibilities, the loss of income may be the real culprit in making higher education unaffordable. While student aid policies clearly cannot solve all of the eco-

[2] Sandy Baum and Kathleen Payea, *Education Pays 2004*. The College Board.
[3] The College Board, *Trends in College Pricing 2006.*
[4] The College Board, *Trends in College Pricing 2006.*

nomic problems students face, the adequacy of funding must be evaluated with these realities in mind.

Net Price: What Students Actually Pay

Over half of all college students, and two-thirds of full-time students, receive grant aid that reduces the net price of college.[5] Many others receive tax credits and deductions that reduce the net price they pay. Net tuition after grant aid is what determines affordability, so our focus should not just be on published tuition and fees. Over the past decade, net price actually fell in real terms at 2-year public colleges. It grew more slowly than published tuition and fees at both public and private 4-year colleges.

It is important to remember that the difference between net price and sticker price is the result of a combination of Federal and State subsidies to students and the discounts, or institutional grant aid, which colleges and universities provide to their students. Institutional grant aid grew about 80 percent in inflation-adjusted dollars over the decade from 1995–96 to 2005–6.[6]

The net price of college requires neither an unmanageable nor a rapidly growing portion of income for students from affluent families, even if they have not saved in advance. In 2003–4, full-time dependent students from families in the top quarter of the income distribution paid about 4 percent of their incomes for tuition and fees and 11 percent for the total cost of attendance at the average 4-year public college. A decade earlier, these percentages were 3 percent and 10 percent. The net tuition at 4-year private non-profit colleges and universities constituted 12 percent of income and the net total cost of attendance 19 percent for these high-income students in 2003–4.

The situation for families in the lower half of the income distribution is quite different. For those students from the lowest quarter of the income distribution who did manage to enroll in college full-time, despite the low tuition and fees, the net total cost of attending a public 2-year college rose from 29 percent of income in 1992–93 to 37 percent in 2003–4. In 2003–4, the net cost of attending a public 4-year college required 47 percent of income for these low-income families, and at private colleges, the figure was 83 percent.

Students from the second income quartile paid only 7 percent of their incomes for net tuition and fees at public 4-year colleges in 2003–4, but the total net cost of attendance required over a quarter of family income. These lower-middle income families used 41 percent of their incomes to attend private non-profit colleges. Students enrolled in the for-profit sector pay net prices very close to those in private nonprofit institutions.[7]

Net Price as a Percentage of Income for Enrolled Students

	Lowest 25% by income (in %)		2nd 25% by income (in %)		3rd 25% by income (in %)		Highest 25% by income (in %)	
	1992–93	2003–04	1992–93	2003–04	1992–93	2003–04	1992–93	2003–04
Public 2-year								
Tuition & Fees	2	3	2	3	2	2	1	1
Total Cost of Attendance	29	37	15	19	13	13	6	7
Public 4-year								
Tuition & Fees	7	8	5	7	5	6	3	4
Total Cost of Attendance	41	47	22	26	16	18	10	11
Private 4-year								
Tuition & Fees	24	35	17	20	14	16	11	12
Total Cost of Attendance	60	83	33	41	25	28	17	19
For-profit								
Tuition & Fees	29	34	14	19	12	11	6	7
Total Cost of Attendance	70	78	29	36	24	24	13	15

Source: The College Board, **Trends in College Pricing 2005**.

Students do not have adequate information about net price. Both the Federal Government and institutions must do a better job of providing them in advance with information about how much they will actually be expected to pay.

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[5] Lutz Berkner et al., *Undergraduate Financial Aid Estimates for 2003–2004 by Type of Institution*. National Center for Education Statistics. NCES 2005-163. 2005.

[6] The College Board, *Trends in Student Aid 2006.*

[7] The College Board, *Trends in College Pricing, 2005*. Based on data from the National Postsecondary Student Aid Study.

Why Is Tuition Rising so Rapidly?

STATE APPROPRIATIONS

It is no surprise that the 34 percent real increase in tuition and fees at public 4-year colleges and universities between 1999 and 2004 was so much larger than the 14 percent increase at private 4-year colleges, since State appropriations per student fell by 14 percent in inflation-adjusted dollars over this 5-year period.[8] Examination of changes in tuition and fees at public institutions over time reveals a consistent pattern, with rapid increase coinciding with tight State budgets and more stable college prices prevailing when appropriations are more generous.

COST DRIVERS

Cycles in State funding do not, of course, explain private college tuition, nor do they provide a complete explanation for increases in public college tuition. While this answer never quite seems satisfactory, the explanation lies primarily with the labor-intensive nature of the process of educating students. While more innovations are certainly possible, it is much more difficult to increase productivity in education than in manufacturing industries propelled by technological innovation. Some prices will always rise more rapidly than the average price in the economy, while others rise more slowly. Education is likely to remain in the former category unless we settle for significant compromises in educational quality.

Tuition increases in recent years have also been fueled by rising costs of health care, energy, and technology. Between 2000–1 and 2005–6, the Consumer Price Index rose 14 percent, while the prices of the goods and services purchased by colleges and universities, as measured by the Higher Education Price Index, rose 22 percent. Colleges spent 72 percent more on utilities in 2005–6 than they had 5 years earlier and 31 percent more on fringe benefits for employees.[9] Both student services and student aid consume increasing portions of campus budgets.

Competition for students is also a factor. Institutions find themselves in a sort of arms race, investing in ever more elaborate facilities and services in order to attract students to their particular campuses. Marketing expenses may enhance the bottom line, but they do little to further the quality of education available to students.

Federal Student Aid Is Not Responsible for Tuition Inflation

Some participants in the debates over appropriate Federal policy for higher education have argued that more generous financial aid only serves to push prices higher as it increases the demand for college. While effective student aid policies do increase the number of students who are able and willing to pay for college, the clear consensus of empirical investigations into this issue is that publicly funded student aid *does not* significantly contribute to rising tuition levels.

Perhaps the most obvious evidence in this regard is that neither Pell Grant levels nor Federal loan limits have been rising in the recent years of rapid tuition increases. One of the many factors fueling price increases may, in fact, be that colleges and universities supplement Federal and State aid with their own funds, so less generous publicly funded aid can increase pressure on institutional aid budgets.

Concerns over the impact of third-party payment are exaggerated, since students and families pay the incremental costs when tuition rises. A few are eligible for more subsidized loans but in general, increases in tuition don't increase eligibility for non-institutional aid. The students who actually pay the published tuition price are not Federal aid recipients and their willingness and ability to pay are not increased when Federal aid becomes more generous. In other words, few institutions have the incentive to increase tuition in response to Federal aid availability.

What Can We do to Slow Tuition Increases?

It is imperative that institutions find better ways to control costs without compromising quality. There are impressive efforts underway to develop strategies such as coordinating purchasing, using technology effectively, and reducing time to degree. But there is no doubt that resistance to innovation is a problem and that much more progress is needed.

While there may be room for the Federal Government to encourage innovative cost-saving practices, no form of price controls or restriction on student aid is likely to solve the pricing problem. Students and families are already voting with their

[8] State Higher Education Executive Officers. Data cited in *Trends in College Pricing 2006*, The College Board.

[9] The College Board, *Trends in College Pricing 2006*. Data from the Common Fund Institute.

feet, choosing less expensive institutions with increasing frequency. Public policy should focus on assuring quality public higher education to all who can benefit from it, not on the few most visible high-price private colleges.

STUDENT AID

Student aid is the best vehicle Congress has to increase college access and affordability. The focus should be on assuring that student aid programs are designed to optimize equity and efficiency, to be well-coordinated, and to minimize the burden of education debt for the many students who will continue to rely on borrowing. Basic principles for policy design include simplicity, predictability and targeting, in addition to adequacy of funding. Moreover, aid policies should be designed not only to provide funds for the transition to college, but also to encourage preparation and promote persistence to degree completion.

Simplification

The need for simplification applies to both the application process and the array of programs and eligibility criteria, to the extent that they complicate the system from the student's perspective. Students should be aware of the aid available and the approximate amount for which they will be eligible early enough to allow them to take the necessary steps to prepare themselves academically for college. They should be able to apply for Federal financial aid without filling out a form that is more complicated than income tax forms. Susan Dynarski and Judith Scott-Clayton of Harvard University's Kennedy School of Government are among the researchers who have provided clear evidence that FAFSA could be considerably shortened without having a major impact on the distribution of Federal aid.[10]

Efforts to simplify the form and the process would likely be furthered by recognition that the Federal methodology creates an eligibility index; it is not a real need analysis or measure of financial capacity. In the longer run, it is surely possible to effectively use the existing income tax system to collect the information necessary to determine eligibility for Federal student aid.

Predictability

It should also be possible to use the income tax system to provide advance information about student aid. For example, when families with children file their income tax returns, they could receive a statement informing them about their potential Pell Grant eligibility. Moreover, if the formula were simplified, it would be possible to construct a look-up table that would provide an estimation of the Pell Grant amount for which students and families with different income levels would be eligible.

Targeting

Student aid from all sources—Federal and State Governments as well as colleges and universities themselves—is less targeted on those who rely on it to enroll and succeed in college than it was in the past. The Federal focus on tax benefits, particularly deductions, the trend towards basing eligibility for State aid on grades and test scores, and the use of institutional non-need-based aid to attract students, all deserve careful review. Financial aid may well serve purposes other than increasing access to educational opportunities, but those purposes should be clearly articulated and evaluated. The central goal of Federal student aid should be to increase educational attainment among students who are interested and able to benefit from higher education, but who do not have the resources to make this achievement a reality.

Federal Incentives for States and Institutions

The Federal Government's role is broader than the distribution of Federal dollars. If the national agenda for student aid is based on increasing educational opportunities for those students for whom finances create insurmountable barriers and assuring the strength of the Nation's future labor force, Congress should also focus on influencing how other partners in the higher education financing process spend their money. This does not require new bureaucracy, but can be achieved through incentives. There is precedent for this strategy in the Leveraging Education Assistance Partnerships (LEAP) program, under which the Federal Government matches State need-based grant dollars. Efforts to revitalize this approach have the potential to maximize the effectiveness of limited Federal dollars.

[10] Susan Dynarski and Judith Scott-Clayton. "The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics," Kennedy School of Government, 2006.

The Federal Government could use a similar approach to influence institutional policies, without creating new rules and regulations. If Congress were to provide financial incentives for colleges and universities to enroll and graduate low- and moderate-income students, institutions would find ways to help students succeed that would be most suitable to the specific circumstances on their own campuses. It is vital that these subsidies focus not only on enrollment, but also on successful transfer or completion, so as not to exacerbate the program of getting students into college but not through college. While there is, on average, a positive economic return to some college, even in the absence of a degree or certificate, that return is much lower than the return to completed credentials. Many students who enroll and then abandon their studies prematurely are left with debt that dwarfs any earnings premium they might enjoy. Encouraging degree completion should be a primary focus in the design of student aid programs.

Anti-Trust Regulations

Another strategy likely to encourage institutions to focus their dollars on students with the most limited financial resources is to loosen the anti-trust restrictions now preventing colleges from communicating about financial aid. Destructive competition is pushing many of them to provide too generously for affluent students at the expense of those with higher levels of need. It is not the wealthiest or the most selective institutions that are engaged in the merit aid wars. The elite private institutions with the highest levels of tuition, as well as some prominent flagship publics, distribute very generous aid packages to low-income students and have largely avoided the strategic use of student aid for other purposes. But those colleges that have less secure finances, that sometimes struggle to fill their seats, and that tend to enroll fewer affluent students, are using many of their aid dollars to attract students with high test scores and/or deep pockets away from competitor institutions.

In several States, the private college associations have expressed considerable concern about this problem and are seeking solutions. They find themselves unable to proceed because of the anti-trust restrictions preventing colleges from cooperating on efforts to direct more of their aid to low- and moderate-income students. Congress could act to relieve this situation and hold the institutions accountable for socially desirable results if they are granted the privilege of cooperation.

Federal Aid Allocation Methodology

Another measure, and a simpler one, that would promote institutions meeting the financial need of their students, would be abolishing the over-award restrictions that prevent colleges from allocating as much need-based aid for many students as their assessment determines is necessary. Currently, students lose their eligibility for subsidized Stafford loans and Federal campus-based aid if the institution meets need that is not revealed by the Federal Methodology. Specific components of the Federal formula have made this problem increasingly common.

The other aspect of the Federal allocation system that is particularly damaging to educational opportunities is the work penalty embodied in the Federal methodology. Students who work many hours in order to supplement their family incomes and/or to make up for the inadequacy of their financial aid packages frequently lose future Pell eligibility as a result of their responsible behavior. The high assessment rate on student income discriminates against hard-working students, in favor of those who have access to other resources to supplement their aid awards.

Using Aid to Encourage Preparation

The debate about whether the gaps in college enrollment and completion across socioeconomic groups are best explained by inadequate academic preparation or by financial constraints is not very constructive, since there is overwhelming evidence that both are major problems. Moreover, they are not entirely distinct. Young people from low-income families whose parents are not college-educated and who live in neighborhoods where college experience is rare are likely to believe that higher education is simply not an option for them. They have little incentive to prepare themselves to take advantage of an opportunity that is so far out of reach. Financial aid programs that provide not only early information about financial aid, but also early commitment of funds, have the potential to encourage academic preparation, in addition to alleviating financial constraints.

Promising policy approaches for financial aid to encourage preparation include:

Matched Savings

There is a growing movement across the country for individual development accounts, where savings of low- and moderate-income families are matched by public and/or private entities. These IDAs could serve as a model for the student aid system.

Savings Accounts for Low-Income Students

The Federal Government encourages families to save for college, subsidizing them through tax-exempt savings plans. Young people whose parents do not have the resources to participate in these programs could receive Federal and State funding to serve the same purpose. Specific accounts for education, with earmarked deposits for young people from low-income families every year as they progress successfully through school would encourage academic success and help move our less-privileged youth into the so-called ownership society.[11]

Partnerships

Partnerships involving the Federal Government, with incentives for participation by States, institutions, and private entities, can combine early commitment of funds and information about aid with the personal mentoring and support systems that have proven to promote access to higher education for low- and moderate-income students.

STUDENT DEBT

Education Debt is Good Debt

The typical student is not drowning in debt. The investment in college is an excellent one, both financially and in terms of other aspects of quality of life and opportunities. The median total debt level for students earning 4-year degrees was $19,300 in 2003–4 and will probably reach about $22,000 this year.[12] Certainly college graduates would be happier not to face this debt, but with average earnings of about $50,000 a year for full-time workers who are repaying these loans—over $20,000 a year more than the earnings of high school graduates in the same age range—this burden is not excessive.

A colleague of mine at Skidmore College, Ngina Chiteji, has analyzed data on young adult debt from the Federal Reserve Bank's Survey of Consumer Finances. She concludes that young adults do not appear to have an unusual or distinctly troublesome relationship to credit markets. Increases in housing debt best explain the increase in the average amount of debt over time for this age group.[13]

Many Students Do Need Debt Repayment Relief

The fact that the typical college graduate can reasonably pay off the typical education debt without undue burden does not diminish the need for Federal policies to alleviate the problems of student debt. It does mean that these efforts should be appropriately targeted.

Despite the high average earnings premium for college graduates, there is considerable variation in earnings among those repaying their student debts. Many never earn degrees. Others enter occupations where they make significant social contributions but sacrifice personal financial gains. The median income for college graduates between the ages of 25 and 34 working full-time is about $50,000. But 25 percent of this group earns less than $30,000 and another 25 percent earns more than $75,000.[14] Clearly taking these earnings differentials into consideration is important in determining who requires additional subsidies from the taxpayers.

Although the average 4-year public college graduate who borrows (about two-thirds do borrow for college), borrows only about $16,000, 15 percent of these students have accumulated over $30,000 in debt.[15] Clearly, focusing on the plight of these heavily indebted students is more constructive than searching for blanket solutions, as though any education debt were problematic. Efficient and equitable policies for alleviating the student debt burden must be targeted at those who are in particularly difficult situations.

Income-Contingent Repayment

The solution to the student debt problem requires taking financial circumstances during loan repayment, not just financial circumstances before college, into consideration when allocating subsidies. The income-contingent loan repayment plans proposed in legislation offered by Senator Kennedy and by Senator Clinton exemplify the approach we should take to this issue. In my research with my colleague Saul

[11] Sandy Baum, "Approaching the Dilemma from Both Sides: PROMISE Credits for Young Students," in *Course Corrections*, The Lumina Foundation, 2005.

[12] U.S. Census Bureau, *http://www.census.gov/hhes/www/income/histinc/p26.html.*

[13] Ngina Chiteji, "To Have and To Hold: Young Adults and Credit Markets," Sheldon Danziger and Cecilia Rouse (eds), *The Price of Independence: The Economics of Early Adulthood* (New York: Russell Sage Foundation Press), forthcoming.

[14] U.S. Census Bureau, *http://www.census.gov/hhes/www/income/histinc/p26.html.*

[15] The College Board, *Trends in Student Aid 2006*.

Schwartz of Carleton University, I have developed principles for a sound loan repayment plan. The policy would eliminate payment obligations for borrowers with incomes below approximately 150 percent of the poverty level, assure that payments do not exceed more than about 10 percent of income for the typical borrower, and require higher percentages of income from borrowers with higher incomes than from those with lower incomes.[16]

Congress should pass legislation embodying the principles incorporated in Senator Kennedy's Student Debt Relief Act and Senator Clinton's Student Borrower Bill of Rights, both of which propose comprehensive income-contingent repayment plans that would solve the problems of most former students.

Economic Hardship Provisions

As long as we do not have comprehensive reform in this direction, the Fair Payment Assurance provisions in Senator Kennedy's Student Debt Relief Act would go far to mitigating the difficulties facing former students with excessive debt. Many of the most serious problems former students face are generated by compounding interest that causes the payment obligations of borrowers under financial duress to increase dramatically. The current system could be greatly strengthened by eliminating the all-or-nothing interest subsidy inherent in the current hardship provisions and removing some of the other work disincentives that have been highlighted by the Project on Student Debt in their analysis of current provisions for economic hardship.[17]

Loan Forgiveness for Public Service

Another approach to mitigating the problems some former students face because of their student debt involves a more comprehensive program of loan forgiveness for public service than we now have in place. I have recently developed a proposal together with Elizabeth Warren and Ganesh Sitaraman of Harvard Law School that we have called Service Pays. This program would forgive a year of debt for each year of public service performed by former students, in addition to assuring a living wage.[18]

Stafford Loan Limits

Finally, any policies designed to address the student debt problem must take into consideration the increasing reliance on private loans, which now constitute about 20 percent of education borrowing. Federal debt relief policies will not affect these loans, some of which carry stunningly high interest rates. Increasing Stafford loan limits is likely the only way to stem the growth of this rapidly growing market that has the potential to jeopardize the future financial security of college students.

CONCLUSION

- Federal student aid policies have made and continue to make a significant contribution to increasing educational opportunities for American students.
- Financial barriers contribute to persistent and unacceptable gaps in college enrollment and success for students from the lower half of the income distribution.
- These financial barriers result from a combination of rapidly rising tuition and fee levels, the additional costs involved in attending college, and the inadequacy of student aid policies.
- It is the net price of college, after taking grant aid and tax benefits into consideration that determines how affordable college is for students and families. Focusing only on sticker prices is misleading and can lead to misguided public policy.
- Congress can best contribute to restraining growth in college prices by providing incentives for innovative cost-savings strategies on campus, assuring that students have adequate information, and maintaining well-funded and transparent student aid policies.
- Federal student aid processes and programs should be simple and predictable.
- To increase access to higher education, Congress should continue to increase Pell Grants and should simplify the application process.
- Congress should target its student aid on those students who need it most, focusing both on financial circumstances before college and on financial circumstances during the period of student loan repayment.

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[16] Sandy Baum and Saul Schwartz, *How Much Debt is Too Much? Defining Benchmarks for Manageable Student Debt*. The College Board and The Project on Student Debt. 2006.

[17] Project on Student Debt, "White Paper: Addressing Student Loan Repayment Burdens," 2006. *http://projectonstudentdebt.org/files/pub/WHITE_PAPER_FINAL_PDF.pdf.*

[18] Elizabeth Warren, Sandy Baum, and Ganesh Sitaraman, "A Ticket to the Middle Class: Working Off College Debt," *Communities and Banking*, Federal Reserve Bank of Boston, Winter 2007.

- The Federal Government should strengthen financial incentives for States and institutions to provide more generous need-based aid to college students.
- Congress should implement programs to encourage preparation for college, including education savings accounts for students from low-income families.
- Through policies such as income-contingent repayment and expanded loan forgiveness for public service, student loan relief should be targeted at the sizeable minority of borrowers whose debt is out-of-proportion to their incomes.
- Other promising approaches to improving the student aid system include raising Stafford loan limits, reducing the work-penalty in the Federal Methodology, loosening anti-trust restrictions on cooperating to increase need-based aid, eliminating over-award restrictions, and rationalizing student loan repayment hardship provisions.

The CHAIRMAN. Very good. Thank you, very helpful. Let me ask you, Dr. Baum, what more should we be doing with regards to just tuition generally? I mean, what we're looking at here are student loans but we also hear the concern about the escalation of tuition. What are your suggestions? I mean, where should we be? Others on the panel might have some ideas as well. I mean, what is the Federal role? What is the State role? How do we get cooperation? How do we also not interfere with colleges that are trying to do innovative kinds of programs and offer greater variety and be on the cutting edge? How do we deal with these issues here? You might get into some ideas about working with the States. What should we be doing? I mean, exemption of antitrust provisions to permit the community colleges to purchase things together? Give us some of the suggestions and maybe the rest of the panel can talk to this as well, please.

Ms. BAUM. I think that's a very important and complicated question but the fact is, that one, if the Federal Government can do anything to stabilize and make State appropriations more reliable, that's very important. It's important to distinguish between cost and price. We do need to provide positive incentives for institutions to come up with innovative ways to control costs. Institutions are best positioned to figure out for their campuses, what the right way to do it is but we can provide incentives. And we need to make sure that when they control their costs, that that's reflected in price reductions. That's the problem, is that cost and price are two very different factors.

You mentioned the antitrust provisions. I talked about that in my written testimony. It is true that colleges are afraid to cooperate on many fronts. They're afraid to cooperate in talking about agreements for providing services and purchasing. They're afraid to talk about cooperating to provide need-based aid. That would be a very important part of the enrollment management problem and the buying of students with non-need-based aid comes from the fact that students are competing with each other and they can't agree not to compete because of the antitrust regulations.

But we should not be punishing students——

The CHAIRMAN. Isn't there a different provision? They can talk without it violating antitrust if it's about athletes or they can't with regards to students?

Ms. BAUM. Yeah, well, we have a lot of exemptions for athletes.

The CHAIRMAN. Okay.

Ms. BAUM. So that way, the highest priority——

The CHAIRMAN. This was not the central thrust of where I was going to go but I'll come back. Now, Dr. Oberg, do you want to comment or the rest of our panel, just on that? Or on my suggestions, please?

Mr. Oberg. Yes. Yes, Mr. Chairman. One of my specific recommendations——

The CHAIRMAN. Let me just describe the issue—people will say, well, this is fine. Again, we're going to look back into the student loan programs and how they can be shaped and reorganized but there will be the suggestion by some, well, even if we are able to do something more for students, we're going to see the colleges will all jack up the price and this thing will be lost for these families. I mean, that will be out there. There is some interesting information showing that the schools where they have the greatest kind of dependency, have not raised tuition. Others have. I mean, that kind of responds to that issue. But I'm interested in the broader kind of question—that most parents will say, well, this is good, you keep working on it, but also we're seeing tuition continue to go up. I'd be interested in what you think we ought to be thinking about on this.

Mr. OBERG. Mr. Chairman, I have one recommendation in my written testimony that deals with a previous effort that was led by this committee, Senator Dodd in particular, the COOL system, the College Opportunities Online. It is intended to be a help to students and families to figure out exactly what prices are and what aid might be at various colleges. One thing it doesn't do very well and it needs to change, is to be able to differentiate between sticker price and net price. Net price is what is paid. You can't tell from the COOL online system what net price might be and one of the things that this committee could do would be to instruct the Department of Education to make that system available to parents and families online.

The CHAIRMAN. Dr. Draut.

Ms. DRAUT. I would just underscore that any way that the Federal Government can incentivize States to stabilize and improve their funding of higher education should be looked at, whether that's providing rewards for those States who do not raise tuition faster than inflation. There is perhaps, maybe a range of ways that could be accomplished but in my mind, the rise in tuition is most directly attributed to the decline in State funding of higher education, which is now at a 25-year-per-pupil low.

The CHAIRMAN. Ms. Orman.

Ms. ORMAN. Mr. Chairman, I'm always going to address this on the personal finance level for the actual people that are involved because that is my expertise here, which is this. While States can do things, while schools can do things, if the actual consumer, the one that uses that product, does not understand how it works, has no idea how to repay back a loan, what is available to them, so I think a lot of money has to go somewhere to educate the actual end use consumer of the things that are out there because they, today, do not have a clue. So we can not just ask States and the government and everybody to offer something when the people using it—they have got to be educated as to why they should use it because they don't have a clue today, in my opinion.

The CHAIRMAN. Senator Isakson.

OPENING STATEMENT OF SENATOR ISAKSON

Senator ISAKSON. Thank you, Senator Kennedy, for holding the hearing. My three children subscribe to the Suze Orman recommendations of paying for my six grandchildrens' education. Every Christmas, I write six checks to their college fund rather than give them gifts so you've done a great job and I try to do the same thing. I want to go back to the statement you just made because I was getting ready to read directly from your written testimony, but I encourage you to also address the need for more and better education on how to handle student loans in the repayment period. It's a failure on our part when we just hand out money to young adults, credit cards or student loans, without truly making them understand the mechanics of how these agreements work.

I cannot tell you how much I ratify that statement and Senator, one of our responsibilities as we look into the entire student loan issue is to figure ways where we can see to it that those students are better educated when they take—when credit is extended to them. I was in a business that depended on credit. I sold houses for 33 years and mortgages are the name of the game and we went through the Truth in Lending laws and Reg C and full disclosure to try and help people understand the component parts of finance. We have that same obligation, I think, on student loans and particularly with young people who, (a) think they are invincible, (b) think they'll live forever and have never, in many cases, yet had to deal with the responsibilities of credit and this is sometimes their very first experience.

Can you give us any suggestions what we might do to help in that education process?

Ms. ORMAN. Well, obviously financial education on the personal level needs to start the day a child enters grammar school, kindergarten up. Why we do not teach it in the majority of our schools, in fact, none of our schools is absolutely beyond me. Home economics should not just be about how you bake. It really needs to be about how do you balance a checkbook, how do you pay for things, where does the money come from, where does it go. It is totally a non-existent topic that is spoken about within a family unit.

So the problem is today, many of the students are getting money. They are using that money for things other than their financial education. They do call into my show and they say, Suze, we don't need it right now. I have 4 years. What if I start to put it in the stock market? What if I do this? And I'm sitting there, how did you get money to begin with? So there are obviously gaps in who gets money, who doesn't get money, what's it used for. I would like to see it go directly to the school and not into the hands of the child, believe or not, because you cannot ask a child or a person to hold money and do something responsibly with it when they've never been taught responsibility to begin with. You would not place a child in the seat of a car and ask them to drive without actually having taught them how to do so because that is a legal weapon otherwise. The same is true with money. So we have got to start teaching it, but who is going to teach these children? Our teachers, that are all at poverty level to begin with? The parents don't know. Grandparents don't know so we have, in my opinion, for middle

America—not the extreme ends but even middle America, a system that has failed them on every single level. They are seduced on the college campuses by credit card companies. They graduate college now with not only student loan debt but credit card debt. They don't understand a FICO score. Because they've paid their bills late, all across the way, they don't have a good FICO score so now they're not getting jobs, they're not getting apartments rented to them—they're moving back in with their parents and again, the whole system is failing. So I think it should be mandatory that before a child is allowed to graduate college—actually, let me put that different. Before a child is allowed to graduate high school, that they need to not only take the SATs, they should take the FATs—some financial exam that they have got to pass before they enter into the world of what could be their destruction rather than their creation because they don't understand money.

Senator ISAKSON. Mr. Chairman, we didn't practice this. I've never had the privilege of meeting Ms. Orman until just now but she has just hit on the main thing we can do. I know nobody is for a national curriculum but when I chaired the State Board of Education in Georgia, we tried to embed in the curriculum in mathematics and home economics and all those things, examples, financial examples of every financial technique—the miracle of compound interest, the problems with add-on fees and things like that. If these kids do understand these things coming out, I think that's a responsibility of education to do so.

One last thing because my time is almost out. The second thing—I know this is about student loans but I just want to make one statement. What is charged by the institutions is part of the problem. We make an increase in the grants and then they raise tuition—we experienced that in Georgia. We passed the Hope Scholarship. Every student graduating from high school in Georgia with a B average has a full scholarship to any State university. The University of Georgia—every freshman is on full scholarship but the problem we had is once we passed that, when we paid for tuition, books and fees and all of a sudden, books and fees started going up, particularly fees. And we can't fix that problem and shouldn't fix it—I'm not a price fixer. I don't want government meddling but the colleges and universities are still trying to, I think, do 20th century education in the 21st century. We've got too much money going into bricks and mortar and not enough into technology delivering content to our students, which is far more effective and my time is out but that is a huge—distance learning, use of technology. The non-traditional student of my day was the student that had to work to go to school. That today is the traditional student and both in time and in curriculum and in accessibility, I don't think the colleges and universities, as a whole, are doing everything they can do to meet the demands of that student and also deliver it in a more affordable fashion.

And I apologize for making a speech rather than asking questions.

The CHAIRMAN. Dr. Oberg.

Mr. OBERG. Senator, I'd like to say, I certainly agree with your exchange here but to add another aspect of it, too and that is, how very complicated our system is. When I was at the Department of

Education, I was frequently on the receiving ends of calls, from CPAs, who would say, I'm trying to fill out the FAFSA or I'm trying to fill out the profile—how does this system work? And I would get into trying to explain and saying, well, under the Federal methodology, here's the result and if you put the institutional methodology on top of that, then here is the result. And if you read the fine print on the various tax-favored instruments, you get a certain effect on your financial aid and if you read it the other way, you get another effect and it may be up to the institution.

My point is, is that our process system is so complicated, I don't know any amount of financial education can adequately prepare a student and a family, even with the best intentions, if CPAs themselves are having difficulty in understanding the consequences.

The CHAIRMAN. Just a—and I'd hope that the Senator would chime in at any time now, just on this point. We here in the Congress have made it more complicated, by and large, more difficult, as Senator Isakson has pointed out, for the student to understand it and the financial experts to understand it. And what we have seen in recent times is a the change of policy here in the Congress, where we targeted money to where the need was but that changed and the public debate said, look, you can get a two-for-one. You can do something for students and get also a tax cut. And that has more zip to it in terms of the politics of the time rather than a spending program that is going to be targeted to needy students. I mean, that happens, I believe, strongly, to have been the atmosphere and the politics of the more recent times. I think this has been true in my party as well as others and I think that has added to these complications, which is an unfortunate take, rather than getting the focus somewhere it's needed.

But I was going to come to this question about the complication—I mean, we are going to try—I believe and we haven't gotten into it. Maybe, Dr. Oberg, you've been restrained when you talk about the 9.5 percent and you weren't going to get in and describe this. I'm interested in how we simplify this. What suggestions across the board do you have in terms of simplifying this system so that people do understand it? And the public understands where their money is going in terms of spending on education. Students understand this. We're going to wrap into the system, a good old concept, which people generally appreciate in this country and that's competition. I know we've got your points, Dr. Oberg and your footnotes, which we will look carefully through. But all of you have given this some thought—are we asking too much in trying to do that?

Ms. BAUM. Could I? I want to address the simplification question. First I'd like to comment on Senator Isakson's comments about the relationship between grant aid and price and what happened with Georgia Hope and I just want to clarify the difference between Georgia Hope and Pell is so extreme. Georgia Hope pays all of the cost for all of the students at this State university and so the State can decide to raise the price and for Pell grants, a small percentage of students at most institutions are receiving Pell grants. They cover far below the whole cost. A whole different picture, so raising Pell grants will be much more effective than the Georgia Hope in that regard.

But on this simplification issue, I think we should abandon the notion that the Federal methodology is a need analysis system. We have a whole complicated system for trying to figure out exactly how much a family can afford to pay. We don't figure it out very well and then they have to pay a lot more than that, anyway. We should just say, here's an eligibility index. If your income is this level, this is how much Federal aid you are going to be eligible to get and then families would know, students would know. We wouldn't need a complicated form to get the information and everyone would understand the system much better.

Mr. OBERG. I would certainly concur with my colleagues on the panel about this. In my written testimony, I also talk about the same thing and that is, if we can somehow spin off this information from our tax system, our income tax system and spin it off early and make it clear to people how much they are going to be eligible for, that would be an excellent change.

There is a bit of an irony here in that the Federal system and all the questions that are asked on the FAFSA are thought to have something to do with how much aid a student gets. But it so complicated now that there isn't much relationship between much of what a person puts on the FAFSA and what the package actually is and I think a lot of this could be done away with and we could go to a much simpler system.

The CHAIRMAN. I might just put up this chart. This is a GAO—Government Accountability Office chart—and it is the flow of funds for the Federal Family Education Loan program. As I understand, Dr. Oberg, you can look at that chart and you'll understand very clearly and I'm sure you can explain it to us all but we'll do that at another time. This is the complexity we've had, but there are alternatives. We have a program, the Direct Loan program, which is a good deal simpler. I think it's more cost effective, myself. Could you talk, the panelists, talk a little about what we ought to expect in terms of the competitive world out there, to advantage the students? No question—I was here when this legislation was first passed and the banks all testified at that table. In this same room. The banks were all out there and they said, we can't do it. We can't afford it. We haven't got the ability to do it and they had to sweeten it and sweeten it and sweeten it and sweeten it and it's gone on now and they are all benefitting. If you can start a bank with a credit card business and the student loans, you can head to Florida tomorrow because you're going to make so much money on these businesses. And we have turned to new Bankruptcy Act to be the enforcer on those credit card companies, many of which are hurting these students.

But let me ask you, what is the role of competition? What should we expect? And then Ms. Draut—I wish the others would comment on this. Ms. Draut, would you like to say a word about that?

Ms. DRAUT. Well, sure. The playing field isn't level between the Direct Loan program and the FFELP program. We know that. The idea was that the two would compete with each other and that the market—let the market work its magic. We now know that between preferred lender arrangements, that the FFELP program has a major upper hand over the Direct Loan program and the percentage of participating schools in the Direct Loan program has been on the decline since it was first started. So my preference is to save money and convert to the Direct Loan program, which I realize politically, is a very challenging and difficult thing to do. That being said, a couple of weeks ago, I was testifying in front of the Senate Banking Committee about credit cards and the role of our government—I keep coming back to this—is to set the fair rules of engagement and right now, the rules are so grossly slanted away from students and from consumers and toward the banks and the student lenders that we have a long way to go before we would sort of be over-intervening in the market.

The CHAIRMAN. How do you react to the statement, well that will be a government-run program and doesn't the government run very good programs? Why should we rely on it? Why would that be more efficient?

Ms. DRAUT. Well, I think if you ask anybody who gets their Social Security check, how they feel about that question, I think they'll tell you that the government, when it puts its mind to it, can run a very efficient, great program and specific to the student financial aid system, I would say, back in 1965, after the Higher Education Act was passed and we actually put money behind the rhetoric of helping low-income people afford college, that the percentage of low-income students who went to college doubled in just 7 years. So yes, the government can do tremendous things. And we've gotten away from the power of the government to create the kind of opportunity where people can achieve their aspirations.

The CHAIRMAN. Ms. Orman.

Ms. ORMAN. Well, I'm not one for competition, believe it or not, in this area because I think competition implies that there are choices. When there are choices, there is confusion. When you have a child or parents that do not understand anything anyway about money, to ask them to choose this over this over that because that over this over that gives you this over that—all of a sudden, they don't know what to do and they do nothing. Or if they do make a choice, it's—they do eeny meeny miny mo. I would like to see one place—I would like to see, just as it was said, I would like to see the government involved with it. I would like to see that you take out the banking industry, so to speak, and somebody has got to look over them because in my opinion, they are all scoundrels, I'm sorry to say and they will do things that benefit their bottom lines at our own sacrifice. So I do think we need to step in here and say, this is how you do it. This is how it works. Not too many choices, again just for income eligibility, I think it is a little bit difficult because there are all different things that go into somebody's income, depending on where they live and what their expenses are so in the same way this panel has said, look at the net cost of a school, one should look at the net of somebody's income and where it has to go, in a different way. I just think to go across the board for income eligibility is really damaging in certain parts of this country where it is very expensive to live. So I would like the choices and the competition, believe it or not, to be taken out of it because we always lose when others are competing over our business.

The CHAIRMAN. Thank you.

Dr. Oberg.

Mr. OBERG. Yes, Mr. Chairman, on the subject of competition, there are some ironies here. The Direct Loan program is actually contracted out on a competitive bid basis for loan origination to private industry. So there is a great deal of competition in that sense, in that there is bidding for it. It uses Treasury capital. Of course, that is a bidding process, too, in how the Treasury raises money. The FFEL program, on the other hand, the subsidy is not set by competition. It is set by legislation and unless you view the legislative process as competition as to how that is set, there is not competition in the same way. That is why there is some interest in bringing in auctions under different arrangements and there have been great studies done by GAO and others about the possibilities of bringing more competition into the system. The question is, of course, would savings through this competition exceed the amount of the reduction in the subsidy that has been proposed by the President? Fifty basis points on the subsidy is a substantial amount, which he would direct to Pell grants and I think that probably, competition through auctions would result in a reduction of greater than that amount but that is very difficult to say.

The CHAIRMAN. Senator Isakson, do you——

Senator ISAKSON. Please, if I could. Five minutes? On the competition on the Direct Loan, that's on the origination fee, right?

Mr. OBERG. That's on the origination of the loan itself. The Department of Education does not, in its bureaucracy, do all this. It contracts that out to originators who make those loans.

Senator ISAKSON. But the capital is appropriated money or in effect, debt of the United States.

Mr. OBERG. Yes.

Senator ISAKSON. And in the competitive program in the private sector, where does the money come from?

Mr. OBERG. It comes from private capital, from bank capital.

Senator ISAKSON. Ms. Draut—is it doctor?

Ms. DRAUT. No.

Senator ISAKSON. I always ask that.

Ms. DRAUT. Thank you.

Senator ISAKSON. What rules are slanted toward lenders? You said the rules were slanted toward lenders. What rules are slanted toward lenders?

Ms. DRAUT. Let me specifically answer that by talking about credit cards, which by the way, have become used by a quarter of students to pay for tuition.

Senator ISAKSON. Okay but also, I want you to talk about rules as they relate to student loans.

Ms. DRAUT. The credit card companies have the right to do something no other industry in this country has the right to do and that is, change the terms at any time for any reason and raise the price of the loan, going retroactively, applying it to your existing balance. So that truism right there, that reality by and of itself and there's all sorts of other tricks and traps that happen, makes it a market enormously slanted towards the lenders rather than the borrowers. In the student loan industry, I think that it's a little different in that the lenders are practically guaranteed a rate of return. So there is not much that they really need to do to be good providers towards the students. What is their incentive to create a product that is really the most convenient and easy to understand towards the student? There is no incentive there because they're going to get their rate of return, regardless of what they do. The other thing I would say is the reality that you can't discharge student loan debts, even under extreme illustration of financial devastation through bankruptcy laws and that is another way that the system is tilted toward the lender interests rather than the student interests.

Senator ISAKSON. Thank you. That point, the latter on student loans, is what I was looking for. On the chart that Senator Kennedy put up and you folks are all a lot smarter than I am, but isn't it a fair statement to say, if you put FHA and VA loans up there instead of student loans, that you'd have the same type of flow chart? And the reason I ask the question—that was my business and the government got in the business of FHA and VA financing to help people get into homes. It insures those loans. The secondary markets provide funds as private capital goes in but it's just as confusing in terms of the flow. But it's a tremendously advantageous program.

Suze.

Ms. ORMAN. I can't comment. I don't know.

Senator ISAKSON. Okay. Well, my point is, Senator Kennedy, charts confuse me and especially around here. We get all kinds of confusing charts but any time you get the government incentivizing the private sector to put its capital into a worthy proposition, which certainly students going to college and people owning homes are, you're going to almost always get—you're going to get that confusing a chart unless the government is just borrowing the money and providing it to the people. So the private sector provides a tremendous need and we have Fannie Mae, Freddy Mac on the conventional loan today, government organizations that were started when the savings and loans failed, to create a capital market to be able to provide funds for housing. The same thing is true on the student loans as well. I'm not saying this in defense of lenders or in defense of anything except to say when you look at a confusing chart and say, wouldn't it be so much simpler if—you have to remember, can you get to the same place you are today in terms of the amount of available capital with just that?

Dr. Baum.

Ms. BAUM. Can I comment on this? Yes. I think that this complexity issue relates both to the loan system and to the student aid system in general, and the complexity is what is a problem for students. The way the system is structured behind the scenes matters but it matters less than how students are affected so that for example, the issue of how can students navigate the student loan system, it's really true that you put 27 options in front of a student, they can't make a decision. There's a warning about the current trend towards direct to consumer marketing of student loans. You get an e-mail message and it says, take out a loan and students are doing that and I think if there is anything we can do to regulate that, we should. But the dichotomy, the idea that what we have is direct lending, which is the government and FFELP programs, which are free market, is just wrong because obviously that's not the free market. We can make that more of a free market without generating increased complexity for students, which is the critical issue.

Mr. OBERG. Senator, comparing the FFEL system with the VA or FHA and so on, I think there are differences in all——

The CHAIRMAN. Bring the mic up a little closer, please.

Mr. OBERG. There are differences in all the systems. One thing that is probably different is in the FFEL system, there is ultimately less risk to the lenders. It is—there is a guaranteed subsidy and there is very little risk because lenders—when students go into default, are guaranteed 97 percent insurance and in some cases, 99 percent and in the President's budget, he has reduced—he has proposed to reduce that insurance from 97 to 95. I think it could go lower than that myself but that would be one difference and I think that is a recognition that the FFEL system may ought to be brought in to line with the other comparable systems in terms of subsidies and risks.

The CHAIRMAN. You know, isn't one of the differences the subsidy? I mean, we have major subsidies in the loan program, which don't exist in the other programs and we do have a simpler system than the complicated one that we've just outlined here. Maybe we ought to look at the FHA and the VA. But we've got subsidies in this program, which people are paying for. I might ask, Dr. Oberg, we've just seen—I guess it's Missouri and Illinois, the State organizations, go and they have sold—they've grouped together all their student loans and then sold those for a 4 to 7 percent profit. Sallie Mae has picked those up. They think they can make a profit, after paying the 4 or 7 percent additional on these loans. Does that say there is some water in this boat or not? I mean, if we find out—and you're familiar with this because there was a question then about who ought to recover that, you know. I know that you think the States ought to recover it and some of us feel that if we are putting it up, the feds should—but that's a different issue. But if they are able, these States, which more of them and more of them are doing now, to put it together and then go out and sell the loans like that, if that doesn't send a message, we've got too much subsidy in this program, I don't know what does.

Mr. OBERG. Mr. Chairman, yes. I think you've touched on a very important point and this is, we need to think of the future here about loan asset sales on a secondary market. Indeed, Sallie Mae and Nelnet did buy Illinois at quite a premium, which shows that those are very good subsidies and those are very—that guarantee is worth a lot. The proceeds of the loan asset sales by these secondary markets raises some interesting questions. I think that the Illinois example is one that is preferable to the Missouri example. Illinois is using its loan asset sales in order to improve student aid through its agency, through its student aid agency. The Missouri MOHELA loan sales are going to be used for purposes, I think, which are really outside the mission of the Higher Education Act and this is one thing that you might consider legislating on as you revise it. The Missouri loan assets are going to be used for capital construction at various campuses in the University of Missouri system, which raises the question of whether or not that is not a State obligation rather than the use of HEA funds. It also raises questions of inducements because institutions are being induced to participate in the MOHELA system and there are also strings attached to the Missouri loan sales that for example, the loan assets that would be used to build the buildings at the University of Missouri at Columbia could not be used for stem cell research and that is stretching the use of Federal loan assets into policies that I'm not sure that—my preference would be that the Congress would legislate on the appropriate uses of loan asset sales at the State secondary markets.

The CHAIRMAN. Let me ask you. If they are doing that and they're making a profit, why don't we do that at the Federal level and sell off then loans, and make a profit, and return that to students?

Mr. OBERG. Senator, that's the essence really, of the loan auction proposals that are floating around out there. There are many different kinds. One of them is to originate and then sell loan assets into the student loan industry at the Federal level, just as the States secondary market.

The. CHAIRMAN. What are you talking about in terms of resources? What could we be making on that?

Mr. OBERG. Well, the student loan originations are very large. We'd be talking in the billions of dollars, depending on how much we wanted to sell. There are some cautionary notes that ought to be added, however, and that is that one of the advantages of the Direct Loan program has been that that debt is held by the United States. The borrowers in the Direct Loan program always know who their servicer is. The loan doesn't get sold around to different servicers. They don't know who to contact and they might get in trouble and lose some of the borrower benefits by loans being sold.

However, in the auction system, we're really talking about auctioning in the FFEL rather than Direct Loan system. As to how much, that is indeed the question and whether or not—I think that the proceeds would probably exceed the President's 50 basis point cut on the subsidy but I can't be sure of that.

The CHAIRMAN. Okay. Just before we leave this, Dr. Oberg, the Department of Education last month announced its settlement with Nelnet regarding the 9.5 loans. You brought this up to the Department in 2003. I guess the settlement didn't include in the recovery that Nelnet should refund the program. Should Nelnet have known that its efforts to expand the number of loans eligible for the high subsidy was questionable? What's your take?

Mr. OBERG. Yes. I think they did know it was very questionable and I think the Secretary of Education last month, made the right decision to say that indeed, the process that Nelnet and other secondary markets were using was illegible and those were illegal payments and she cut off all future payments using that particular bond manipulation scheme. I think that was the right answer. I think, however, that part of that answer to forgive $322 million to Nelnet in past illegal payments was inappropriate and furthermore, if she also forgave in advance, other secondary markets for their illegal payments and before they have been audited, we don't know which secondary markets those might be or what kind of money might be at stake and that is the basis of my recommendation that before everything is approved at the Federal level, that the committee ask for some oversight through the Department of Justice.

The CHAIRMAN. Did you have any comments on the auctioning off of student loans? Senator Isakson, anything further?

Senator ISAKSON. No. I thank the panel for coming.

The CHAIRMAN. Well, we're going to have some questions from some of our colleagues here. We thank you all. We had this hearing scheduled earlier and we've got several organizations in the higher ed community to submit testimony and we'll include that in the record.

And we changed and altered that and inconvenienced you all but we're very grateful to you and if there were questions that—we'll submit some questions. I'll just mention one final thing today. In your book, I saw your reference to what the cost was of tuition at Harvard and my brother, Bobby, was a seaman on a destroyer but he came back to Harvard just at the end of the war and as you point out, it was $100 a course. A hundred dollars a course. And they took four courses at Harvard for the year and it was $50 for the books and $50 for athletic fees. And that was $500 and that's what they received. They got $500 a year for the education and then, I guess as you pointed out, the $50 a month, the stipend for living expenses. But it's how a whole generation of veterans got through in that post-war period. And my understanding, I heard from a wonderful friend, a good Republican, Sil Conte, who was from Massachusetts and followed this very, very closely all the time he was a member of the House Appropriations Committee. For every dollar that was invested, $7 came back to the Treasury. We've started to lose sight of this in our country that you couldn't spend a dollar that's more effective, I don't think, probably, than in these areas of education. I don't know if there is anything you want to add.

Ms. DRAUT. Sure, a couple points. I agree with you completely. I mean, we built the middle class that we have today that is a signature strength of our Nation through efforts like the GI bill and I agree with you. It's an investment that at this point, we can't afford not to make and we are under-investing at this point in terms of the amount of money spent on need-based grant aid. I would like to take this opportunity to make one point about student loan debt because it hasn't been touched on. I do think the average amount of student loan debt today, which is around $19,000, is too much for the typical borrower. And let me tell you why. We make a lot of big deals—and I get asked this all the time. Why shouldn't students have to take on the responsibility of a $20,000 student loan payment if they're going to end up earning a million dollars more than somebody without a college degree and that's true. Absolutely, you will earn more if you have a college degree but what is also true is that the median earnings of a 25- to 34-year old with a college degree have declined in three decades, after you adjust for inflation. College—your typical college earners are no better off today than they were a generation ago yet we are asking them to add a significant—whether it's 8, 10, 12 percent to those earnings, which are again, less than they were a generation ago. At the same time, this generation also faces much higher costs for things like housing and health care. So this really is an undue burden if you look at it, if you step back and look at it in a larger economic context. That million dollar premium isn't coming because college earners earn so much more today than they used to. It's happening because high school degree workers are earning so much less and that's a really important distinction to think about when we talk about the average student loan debt that the typical graduate is paying today.

The CHAIRMAN. Okay. I see.

Ms. BAUM. Could I make a brief comment to that?

The CHAIRMAN. Sure, that's fine.

Ms. BAUM. I mean, somebody has to pay. It would be great if it were cheaper. We should try to make it cheaper to educate students but somebody has to pay and it's not the people who don't go to college who should bear a bigger burden and so people who do go to college do get a much bigger return that they would have a generation ago. Somebody has to pay. Certainly people who go to college and end up with the good return—not those people who don't benefit from going to college—but those who do have higher earnings have to make a contribution. Twenty thousand dollars—they borrowed $20,000 after they graduate to buy a car. So there are many students with problems but it's not the general taxpayer who needs to bear—they need to bear a part of the burden, obviously there are very positive social benefits to higher education but students will continue to have to borrow.

The CHAIRMAN. Ms. Orman, did you have anything to add?

Ms. ORMAN. And the last thing is, because obviously there is a difference of opinion here but the $20,000 student loan isn't just $20,000 because we have not educated our students on compound interest, as you so wanted to teach everybody later on and we have offered them solutions—deferment, forbearance, whatever it may be, the students don't understand what it means when they do not pay back their student loan. They defer, they defer, they defer. The interest rate is then compounding and it is not then a $20,000 student loan, it is now a $60,000 or $80,000. They are not getting notices from the student loan companies. Nobody is showing them their balance growing. They just know they're in deferment and all of a sudden they get hit and they owe $80,000 when it started out as $20,000 and now we have ruined that person's life. Again, I go back because we did not educate them. We do not send them statements. We have not shown them at the age of seven what it will go into and it all starts and ends with education of the student.

The CHAIRMAN. We thank all of you. It's been very interesting, very, very helpful. We thank all of the students. We don't know how many are missing class today. We'll give you—we won't dock you for that. Thank you very much. You tell them that Professor Kennedy gave you an A today. Thank you very much..

The committee stands in recess.

[Additional material follows.]

ADDITIONAL MATERIAL

PREPARED STATEMENT OF SENATOR ALEXANDER

I am pleased that the committee is starting the new Congress with a hearing on the costs of higher education. About one half of American college students have a Federal grant or loan to help pay their tuition.

It is necessary to remember that the Federal Government plays an important role in imposing costs on our institutions of higher learning through regulatory policies that Congress and the executive branch establish. Every time we impose a new policy, a new data system, a new requirement on colleges and universities, we impose costs. We must be diligent in our efforts to reduce the regulatory burden on higher education, or else all of our other efforts to improve student aid or reduce student costs will be vastly diminished.

I believe the greatest threat to the quality of American higher education is not underfunding, it is overregulation. The key to the quality of our higher education system is that it is NOT a system. It is a marketplace of 6,000 autonomous institutions. Yet, thanks largely to the last two rounds of reauthorization of the Federal Higher Education Act, each one of our 6,000 higher education institutions that accepts students with Federal grants and loans must wade through 7,000 regulations. The President of Stanford has said that 7 cents of every tuition dollar is spent on compliance with governmental regulations.

It is also important to remember that the rising costs of Medicaid have soaked up State tax dollars that States otherwise would have spent on higher education, and that has been a major cause of rising tuition. To be specific, nationally, during the 5-year period 2000 to 2004, State spending for medicaid was up 35 percent, while State spending for higher education was up only 6.8 percent. As one result, tuition was up 38 percent at State institutions.

The story in Tennessee has been worse. Medicaid spending was up 71 percent, while higher education was up 10 percent, and tuition was up 43 percent. By the way, during this same 5 years Federal spending for higher education was up 71 percent.

When I left the Governors office in 1987, Tennessee was spending 51 cents of each State tax dollar on education and 16 cents on health care, mainly Medicaid. Today it is about 40 cents on education and 26 cents on health care, mainly Medicaid.

To give governors and legislatures the authority properly to allocate resources, congress should give States more authority over Medicaid standards and more ability to terminate outdated Federal court consent decrees that remove decision making authority from elected officials. Those would be important steps in reducing the cost of higher education for many students.

I would also like to focus some attention today on the Direct Loan program. The Direct Loan program was created in 1992, while I was Secretary of Education. Although it was started as a pilot program, I was skeptical about the program from its beginning. It did not make sense to me to add billions of dollars to the Federal deficit by borrowing to start such a huge program. And I could not imagine the government managing such a large enterprise more efficiently than the private sector. My views have not changed.

As we debate the Direct Loan program and the Federal Family Education Loan (FFEL) program in general, I look forward to learning more about the true cost of the Direct Loan program. I am concerned that the current methods of estimating the costs of the program aren't accurate and rely on generous assumptions. I am also concerned that the operational costs borne by the Department of Education are not factored into the program. These questions must be resolved so that we can have a fair comparison between the two programs.

As we look at the Federal Family Education Loan (FFEL) program, I share the concern about the expense of the program. I am willing to explore policies to change or improve the FFEL program. But I caution my colleagues, and the Administration, that we must be careful in any changes that we make.

We need to think carefully about the role of private lenders in the FFEL program. We must ensure that a vibrant and competitive market remains for colleges and universities, and most importantly for our students. The success of our economy is based in large part on our successful higher education system, and any significant changes that could impede the ability of our citizens to obtain a high quality education must be viewed with great scrutiny.

I look forward to working together with my colleagues to find practical solutions to the costs of higher education, and ensuring that American families can afford to send their children to college.

PREPARED STATEMENT OF CONSUMER BANKERS ASSOCIATION

The Consumer Bankers Association (CBA)[1] is pleased to submit this statement for the record in connection with the committee's hearing today. CBA is the national trade association specializing in retail, consumer and small business banking. Our members hold 75 percent of the Nation's bank deposits and are engaged in the full array of consumer loans and financial services products to help our customers, their families, and their financial futures. CBA is the leading association of bank lenders participating in the Federal Family Education Loan program.

In recent weeks, a number of ideas have been raised on how to help students and other borrowers cope with rising student loan debt resulting from rising college tuition costs. Today's hearing includes testimony on ideas on how to "reform" the student loan program. In this statement we hope to provide you with the perspectives of banks in the FFEL program and to share our thoughts on what is at stake in the current debate.

First, let there be no mistake about the position of banks on the issue of student debt: We share the concerns of all members of this committee about rising levels of debt. We welcome constructive amendments to the Higher Education Act to assist borrowers that find themselves facing increasing debt burdens.

Second, we note with some reluctance that the primary cause of rising student loan debt is not the existence of the current Federal student loan programs, but the fact that the cost of education continues to rise faster than the rate of inflation. In this regard, CBA is pleased that one of your four witnesses today, Dr. Sandy Baum, is an expert in this area and will be able to shed some light on this central element of the college affordability debate.

[1] The CBA is the recognized voice on retail banking issues in the Nation's capital. Member institutions are the leaders in education finance, consumer, auto, and home equity, electronic retail delivery systems, privacy, fair lending, bank sales of investment products, small business services and community development. The CBA was founded in 1919 to provide a progressive voice in the retail banking industry. The CBA represents over 750 federally insured financial institutions that collectively hold more than 70 percent of all consumer credit held by federally insured depository institutions in the United States. CBA members regularly include arbitration agreements in their consumer loan documents and deposit contracts.

Third, we note that all known solutions to making college loans more affordable are expensive. We also understand that in the current political and fiscal environment, members of both political parties are unwilling to call for a new Federal investment in education to meet these costs, and thus members of both parties are looking to cuts in the FFEL program as a short-term means of meeting them.

Because of these three circumstances, loan providers in the FFEL program find themselves in the curious position of having to defend private sector participation in the student loan program. The program, as you all know, is currently subject to proposals ranging from multi-billion reductions in lender yield, to paying schools to quit the program in favor of the presumably less-expensive Direct Loan program, to naive proposals such as eliminating the guarantee on FFEL loans while at the same time presumably not increasing interest rates on any borrowers.

FFEL loan providers believe that Congress and the Bush administration are in immediate danger of throwing the baby out with the bathwater. In this case, private sector participation in the student loan programs is the baby.

Lenders, guarantors, services, and others involved in the FFEL program offer considerable added value to students, to parents, to schools and to taxpayers. This added value, however, seems to have been forgotten or ignored in a hurried rush to craft solutions to the problem described as borrower over-indebtedness.

The added values offered by FFEL loan providers fall into four categories:

Reliability: Put as simply as possible, loans are available for all students who need them. This is currently the case and has been the case for over 42 years. In contrast, in its relatively short history, the Direct Loan program has already been subject to one catastrophic failure. This occurred in 1997 when the Department of Education's contractor for processing Direct Consolidation Loans was overwhelmed by the volume of applications received, resulting in months-long delays for borrowers. After hearing from numerous constituents whose plans to buy a home or car were put on hold, Congress eventually addressed the situation by enacting the Emergency Loan Consolidation Act, Public Law 105–78.

Proven Effectiveness in Addressing Defaults: The FFEL program has been very successful in reducing borrower defaults and delinquencies. Defaults in the student loan programs reached 22.4 percent in fiscal year 1990. For fiscal year 2004, the most recent year for which rates have been published, that rate had dropped to 5.4 percent. This remarkable progress results, in large part, from investments in technology and customer service by lenders, guarantors, and loan servicers.

Much of the human and capital investment behind this achievement occurred not as a result of new Department of Education regulation or even the desire to avoid losses on borrower defaults—it occurred as a result of competition between loan participants in the marketplace attempting to meet the needs of their customers, both borrowers and schools. Today, the cohort default rates on Direct Loans are higher than those on FFEL loans for every category of loans.

World-Class Technology and Customer Service: FFEL program participants have adopted world-class technology to facilitate every aspect of the administration of student loans. Schools have access to ELM Resources to facilitate loan origination and to track account data. Borrowers can apply for loans on-line and use an electronic signature. Borrowers can also access their account data and conduct transactions relating to their accounts, such as applying for deferments, on-line.

None of these investments were mandated by regulation or statute. They occurred both because FFELP loan providers want the program to work for borrowers and because marketplace competition requires them to match the best efforts of their competitors.

Lower Cost Loans to Borrowers: Generally speaking, FFELP student and parent loans cost less than Direct student and parent loans. This occurs because FFELP loan providers invest part of their own earnings to discount origination fees and interest rates for borrowers. As is the case with the quality of loan servicing, none of these discounts is required under the Higher Education Act or regulations. They result from marketplace competition—competition between private lenders.

Recent legislative proposals, including some put forward this week, would greatly reduce or eliminate the value-added in the FFEL program. They would reduce lender return below the level that makes offering these benefits possible. Worse, they would shrink the FFELP market by paying schools to use the Direct Loan program, notwithstanding the schools' obvious decisions that FFEL best meets the needs of their students.

In addition, the cuts to FFELP loan providers proposed in the President's fiscal year 2008 budget make no sense on two counts. If we assume the Department of Education is interested in students having access to the lowest-cost loans supported by the highest-possible customer service, they make no sense. Second, the Direct Loan program serves only about 20 percent of the overall Federal student loan market. If we assume, as many do, that the Department would have trouble doubling or tripling its capacity in 12 to 18 months, the cuts certainly make absolutely no sense.

Let's turn specifically to the STAR Act, one of the proposals currently pending. This legislation represents bad education and fiscal policy from a number of perspectives.

Reliance on unreliable budget estimates. The STAR Act is based on budget scoring rules that have been questioned repeatedly by budget experts. More importantly, the act relies on cost estimates that have proven to be unreliable. For example, the President's fiscal year 2008 budget "re-estimates" the cost of the Direct Loan Program, revising its costs upward by over a billion dollars above estimates issued just 1 year ago. These upward re-estimates of costs have taken place numerous times during the short history of the Direct Loan Program. Yet the STAR Act would immediately seize projected savings—that, is hoped-for savings that may never be realized—and spend them now to pay schools to quit the FFEL program.

To bankers, this scheme seems like bad financial policy, especially since Direct Loan administrative costs would probably shoot up if loan volume skyrocketed as a result of this legislation.

Reliance on the same inducements proposed to be made illegal in the Student Loan Sunshine Act. The STAR Act is also bad education policy because it incorporates the use of inducements to persuade schools to deny their student and parent borrowers a choice of lender. In many cases, such a restriction will result in denial of access to a lower cost loan. In all cases, borrowers will have no choice but the Department of Education as their loan servicer.

If providing inducements to secure loan applications is wrong in the FFEL program—and CBA and its members believe it is—it should also be wrong in the Direct Loan program. And, unlike some of the inducements in FFEL that are currently considered improper, those proposed in the STAR Act will, in almost every case, deny a borrower access to a lower cost loan.

The FFEL program has served America well. It should not be jeopardized by new cuts on top of the more than $18 billion in cuts to FFELP loan providers that were enacted as part of the Higher Education Reconciliation Act in 2006. It should not be jeopardized by schemes like the STAR Act, nor by an auction of the right to make, hold, guarantee or service student loans.

A priority for this committee and for the Congress should be to support a reliable, innovative, and responsive student loan program. FFELP is such a program.

CBA and its members urge the Committee on Health, Education, Labor, and Pensions to reject the easy temptation to seek short-term savings from the FFEL program that jeopardize its vitality, even if the savings are to be used to pay for new benefits for borrowers or for new grant aid. We urge the committee to take a measured, longer view of the good the FFEL Program has done for our country over the past 40 years and preserve this very successful private-public partnership for the good of future students.

Congress and the administration should work together to address the problem of student debt and to find new resources to fund needed changes. CBA and its members would welcome the opportunity to work with you on this goal.

NELNET,
LINCOLN, NE 68508,
February 16, 2007.

Hon. EDWARD M. KENNEDY,
Chairman,
Committee of Health, Education, Labor, and Pensions,
U.S. Senate.

Hon. MICHAEL B. ENZI,
Ranking Member,
Committee of Health, Education, Labor, and Pensions,
U.S. Senate.

DEAR CHAIRMAN KENNEDY AND SENATOR ENZI: I am writing to respond to misstatements concerning Nelnet in Jon H. Oberg's written testimony, which will be presented to this committee at its hearing today. Specifically, his characterization that the Secretary of Education determined that Nelnet's billings for 9.5 percent special allowance payments (SAP) were illegal is simply wrong. Neither the Department of Education nor the Department's Office of Inspector General (OIG) questioned the legality of the billings, and actually the issues raised amount to nothing more than a good faith dispute. To suggest that there was something different is a gross mischaracterization of the facts, and one that unfairly attempts to taint Nelnet and the entire student loan industry.

Nelnet's qualification of loans for the 9.5 percent SAP conformed to existing Department regulations and interpretations that have been long understood by the Department. In fact, it was Nelnet that approached the Department and brought to its attention how lenders could qualify additional loans for the 9.5 percent SAP under existing regulations.

Throughout the extensive policy debate on this issue, no one ever raised any question with Nelnet about the manner in which it qualified loans for the 9.5 percent SAP until the OIG challenged the practice in an audit. The OIG presented a novel—and highly dubious—re-interpretation of the applicable statute and regulations to challenge the 9.5 percent payments to Nelnet for what the OIG newly labeled as "third-generation loans."

Nelnet vigorously disputed the OIG's conclusions, presenting detailed analyses showing that the OIG's interpretation ignored the realities of student loan financings, was inconsistent with the Department's public statements and its long-standing practice of making 9.5 percent payments on third-generation loans, and conflicted with two pieces of legislation that restricted eligibility for 9.5 percent SAP *prospectively*, thereby grandfathering what were almost certainly third-generation or later loans.

To resolve the dispute, the Department and Nelnet entered into a settlement agreement. In the agreement, the Department recognized that, at a minimum, there were "bona fide, good faith disputes and controversies" regarding the issue. The Department's acknowledgement of the existence of "bona fide, good faith disputes and controversies" is utterly inconsistent with Dr. Oberg's characterization of Nelnet's actions and the Department's views.

There simply is no basis for Dr. Oberg's claims. When Nelnet submitted requests for 9.5 percent SAP, the Department understood the basis for those requests and appropriately paid them. Any claims to the contrary are simply wrong, and the committee should not credit them.

Sincerely,

JEFF NOORDHOEK,
President.

QUESTIONS OF SENATOR ENZI FOR SUZE ORMAN, TAMARA DRAUT, JON OBERG, AND SANDY BAUM

QUESTIONS FOR SUZE ORMAN

Question 1. I commend you for all you have done to raise the level of financial literacy in the country today. You have raised the consciousness about the need to have good financial information and make good financial decisions. How can we help prospective students ask the right questions to find out how much specific colleges will cost them so they make informed decisions?

Question 2. Many of you have talked about the problems young adults face with managing their finances. But I wonder if we're really addressing the core issues. The need analysis concepts we use and the financial aid programs we use are rooted in the past, when the typical postsecondary student was an 18–22 year-old dependent student. The typical postsecondary student now is a "non-traditional student," an adult who may have family responsibilities. How would you change the way we evaluate student resources and expenses to serve today's students better?

Question 3. We've talked about the cost of college and the cost of money, but what about the value of the education students are getting? How can students tell what they are getting for their money and if it is what they need?

Question 4. There has been discussion about student loans as "good debt," but one we need to manage better, begs the question how we go about doing that. Should we consider getting the Department of Education and private lenders out of the student loan business and running the student loan programs out of the Department of Treasury, advancing funds and collecting repayment through the Internal Revenue Service?

[Editor's Note: Responses to the above questions were not available at time of print.]

QUESTIONS FOR TAMARA DRAUT

Question 1. Many of you have talked about the problems young adults face with managing their finances. But I wonder if we're really addressing the core issues. The need analysis concepts we use and the financial aid programs we use are rooted in the past, when the typical postsecondary student was an 18–22 year-old dependent student. The typical postsecondary student now is a "non-traditional student," an adult who may have family responsibilities. How would you change the way we evaluate student resources and expenses to serve today's students better?

Question 2. We have both need- and merit-based student financial aid. What role does each kind of aid serve, particularly at public institutions?

Question 3. The college degree of today is like the high school diploma of the 1950's. It's the key to success. Yet many people leave the educational process before they attain the degree. Some drop out of high school. Some finish high school, but do not have the knowledge and skills they need to succeed in either postsecondary education or the workforce. They may start postsecondary education, but then drop out, leading to a sense of defeat. What can we do to turn this around, to improve college entrance and completion rates?

Question 4. We've talked about the cost of college and the cost of money, but what about the value of the education students are getting? How can students tell what they are getting for their money and if it is what they need?

Question 5. There has been discussion about student loans as "good debt," but one we need to manage better, begs the question how we go about doing that. Should we consider getting the Department of Education and private lenders out of the student loan business and running the student loan programs out of the Department of Treasury, advancing funds and collecting repayment through the Internal Revenue Service?

[Editor's Note: Responses to the above questions were not available at time of print.]

QUESTIONS FOR JON OBERG

Question 1. Many of you have talked about the problems young adults face with managing their finances. But I wonder if we're really addressing the core issues. The need analysis concepts we use and the financial aid programs we use are rooted in the past, when the typical postsecondary student was an 18–22 year-old dependent student. The typical postsecondary student now is a "non-traditional student," an adult who may have family responsibilities. How would you change the way we evaluate student resources and expenses to serve today's students better?

Question 2. Students of all ages, and their families, need easy to understand information on costs and available assistance. Both of you have pointed out that the current financial aid form, the Free Application for Federal Student Assistance, or FAFSA, is long and hard to fill out. Should we think about a change in the mechanism we have for determining student aid eligibility? Would it make sense to let taxpayers ask for an eligibility determination when they file their tax forms?

Question 3. We've talked about the cost of college and the cost of money, but what about the value of the education students are getting? How can students tell what they are getting for their money and if it is what they need?

Question 4. You have testified that your research has showed that a substantial number of students with remaining Federal eligibility loan eligibility were taking out private loans at less favorable terms. Can you tell us more about the amount of remaining eligibility we're talking about? And what needs to be done to provide students information to make informed decisions.

[Editor's Note: Responses to the above questions were not available at time of print.]

QUESTIONS FOR SANDY BAUM

Question 1. Many of you have talked about the problems young adults face with managing their finances. But I wonder if we're really addressing the core issues. The need analysis concepts we use and the financial aid programs we use are rooted in the past, when the typical postsecondary student was an 18–22 year-old dependent student. The typical postsecondary student now is a "non-traditional student," an adult who may have family responsibilities. How would you change the way we evaluate student resources and expenses to serve today's students better?

Question 2. Students of all ages, and their families, need easy to understand information on costs and available assistance. Both of you have pointed out that the current financial aid form, the Free Application for Federal Student Assistance, or FAFSA, is long and hard to fill out. Should we think about a change in the mechanism we have for determining student aid eligibility? Would it make sense to let taxpayers ask for an eligibility determination when they file their tax forms?

Question 3. You have noted that there are unacceptable gaps in college enrollment and completion rates between students from privileged backgrounds and those from low to moderate income backgrounds and that this is due to a combination of inadequate academic preparation and financial barriers. What more can we do to address the root problems?

Question 4. The college degree of today is like the high school diploma of the 1950's. It's the key to success. Yet many people leave the educational process before they attain the degree. Some drop out of high school. Some finish high school, but do not have the knowledge and skills they need to succeed in either postsecondary education or the workforce. They may start postsecondary education, but then drop out, leading to a sense of defeat. What can we do to turn this around, to improve college entrance and completion rates?

Question 5. We've talked about the cost of college and the cost of money, but what about the value of the education students are getting? How can students tell what they are getting for their money and if it is what they need?

Question 6. You have explained that net price is what students actually pay. Yet most students focus on the quoted tuition price and constant increases in tuition. What can we do to slow the tuition increases? And what can we do to help students get a better understanding of what postsecondary education will actually cost them?

[Editor's Note: Responses to the above questions were not available at time of print.]

[Whereupon, at 11:25 a.m., the hearing was adjourned.]

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