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REPORT CARD ON TAX EXEMPTIONS AND INCENTIVES FOR HIGHER EDUCATION: PASS, FAIL, OR NEED IMPROVEMENT?

HEARING

BEFORE THE

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REPORT CARD ON TAX EXEMPTIONS AND INCENTIVES FOR HIGHER EDUCATION: PASS, FAIL, OR NEED IMPROVEMENT?

TUESDAY, DECEMBER 5, 2006

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Present: Senators Thomas, Bunning, Baucus, Bingaman, Lincoln, and Schumer.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. Today we are holding a hearing, what we call an oversight hearing, on tax benefits for higher education. We will look at both the incentives we provide families and students to help pay for education, and also the significant amount of tax breaks that we provide colleges and universities because they are tax-exempt organizations.

The Joint Committee on Taxation, as you know, are the people who spend their lifetimes, in a professional way, looking at the impact of taxation on the economy and the amount of money it brings in or does not bring in. That committee has estimated that the tax benefits to individuals to assist with higher education for 2006 through 2010 will be approximately $49 billion.

The tax breaks provided to colleges and universities are also significant for these institutions because they are allowed to issue tax-exempt bonds, and are exempt from income tax, and benefit from deductions allowed for charitable organizations.

Unfortunately, it appears that far too many colleges' and universities' response to efforts to make college affordable by the Congress and by the private sector—particularly our Nation's elite institutions—has been a bad triple play: big tuition increases, expanding endowments, and now very, very high salaries for college presidents, although one of the issues in my State of Iowa is whether or not we are offering to pay enough to fill a vacancy at one of our State universities.

The Finance Committee considered some of these issues in April of 1997, when we considered the Clinton administration's proposal for the HOPE scholarship, as well as other tax breaks at that time to help pay and save for college.

Many members at that hearing expressed concern about rising tuition costs. There was even discussion about how incentives for education savings and other tax changes could possibly reduce the rampant increase in tuition costs.

We will hear testimony today about research that considers whether additional tax breaks have been a factor in increasing tuition and reducing institutional financial support.

However, one thing is clear: the tax incentives we passed have certainly done nothing to limit the rapid growth in tuition that was investigated by this committee back in 1997.

Since 1976, college tuition and fees have risen by more than twice the economy's overall price level. Imagine that! The burden on families and students has risen by twice the rate of inflation.

So, members of this committee have been very, very concerned, when we would apply that same principle to high medical costs in this country, and we ought to do something about it. I think it is legitimate to raise the issue about the costs on families of going to college.

In our 1997 hearing, we had discussion of what Senator Moynihan, then Ranking Member, termed as "Baumol's disease." The committee looked at this theory as a justification for ever-increasing tuition, basically the point being that because colleges are so labor-intensive, they cannot benefit from improvements in productivity that occur in the rest of the economy.

However, it does not have to be that way. Many colleges and universities are working hard to keep costs under control and to make sure that working families are not overwhelmed by the costs of college.

Two examples in my own State, Drake University and a small college in northwest Iowa called Northwestern College, have taken steps to get a handle on tuition increases. It can be done. I will include in the record a letter from the president of Drake, as well as an extensive discussion of the work Drake has done in this area.

[The letter appears in the appendix.]

The CHAIRMAN. I would suggest to my colleagues that efforts to stop the galloping inflation of college costs failed when we tried to address it on the demand side. I think it is time for us to consider—and I do not have any thoughts beyond considering, but that is what this hearing is all about—what incentives or requirements might make sense for colleges and universities that receive these billions in tax breaks, particularly our elite institutions with massive endowments, for best practices to keep tuition costs in hand and to assist working families to attend and pay for college.

Should we expect better information and transparency of what colleges are doing to control costs, who they are admitting, and other important information? Should colleges with big endowments be required to pay out funds and dedicate some of those funds to keep tuition costs in check for working families? Maybe these universities already figure they are doing a great deal of that.

Should some tax breaks for colleges be dependent on their keeping tuition inflation under control? Are tax breaks such as tax-exempt bonds actually encouraging behavior such as increasing tuition and reducing the number of students accepted from working families?

Now, you could add a lot of questions to what I just asked, but these are some of the questions and some of the ideas—and there are many more—that we need to be thinking about.

The information prepared for today's hearing by the Congressional Research Service and Joint Tax is very informative, and I commend it to the attention of members and staff. I particularly note the issues that CRS and Joint Tax raised regarding these massive endowments at some universities that have no requirement to provide a penny to help students pay for college.

I know that looking at colleges and universities is a very tough task, and tougher than the easy journey of just voting for more tax breaks for tuition. I have supported and have helped to champion those tax breaks in the past, and hopefully to get them reauthorized right away.

Of course, I look forward to working with Senator Baucus to extend these proposals in this Congress, and, if we do not get it done, then doing more maybe even in the next Congress.

That is why it is all the more unfortunate that some on the other side have decided to make political points off of what has been a bipartisan matter for years. If you look at the rhetoric and ads in the last campaign from the other side—meaning the Democratic Party, a lot of times, not maybe specific members of Congress—you would believe that none of these recent education tax relief proposals came out of a bipartisan effort of this committee.

In fact, the truth is that all of these measures were very bipartisan and enacted during Republican congressional control. However, I am very fearful that additional tax breaks for education without encouraging best practices by colleges and universities will not even be helping working families keep up with the rising costs.

The need for this committee to train its eyes on tax breaks for education has received important support from Mr. Charles Miller, who was chairman of the Secretary of Education's Commission on the Future of Higher Education, which recently released a report. I would enter his letter of December 1 in the record.

[The letter appears in the appendix.]

The CHAIRMAN. He makes several points about the importance of holding colleges more accountable, and also emphasizes the need to clean up the confusion and complication of tax breaks that assist families to pay and save for college.

Reform of the tax code in this area is also an important part of this hearing. We have proposals from Joint Tax and the President's Tax Reform Panel to reform the maze of tax laws when it comes to paying and saving for education. We will hear more about what can be done in this area to make these incentives more effective.

It is very discouraging that many students and their families are not taking full advantage of the tax incentives that we have provided because of confusion and uncertainty. We need to make simplification in this area a priority, and my hope is that the administration will put forward a credible proposal.

Last, we will be hearing about a new issue in this committee, which is a significant number of enrollment spaces at our Nation's elite colleges that are reserved for children of alumni, children of teachers, and the children of multi-millionaires whom the universities hope might give more money down the road.

All this means fewer spaces for children of working families. The reality is that, for a smart high school student from Waterloo, IA, the number of spaces available at a top college is a lot fewer than might meet the eye.

We need to think about whether reserved spaces at our top colleges is a public policy that should be subsidized by the tax code, as is currently the case, and also whether it is in keeping with the requirements that charities, colleges, and universities operate in the public interest.

I look forward to this testimony and encourage other interested parties to submit their views and comments on how to deal effectively with these issues.*

Before I ask Senator Baucus to speak, I would simply like to make a tribute to him as Ranking Member over the last 4 years, cooperating with me. This will probably be the last hearing that we will have that I will chair, so it gives me an opportunity to express to him my gratitude for the great deal of cooperation.

More importantly, and something I do not think he, I, or this committee gets proper attention from the public for, or particularly people who are naïve about how Congress operates, that everything in this Congress is in conflict; every Republican is punching every Democrat, and every Democrat is punching back.

In this committee, there has been a great deal of cooperation and, at least over the last 2 years, I can think of only one issue that did not get out of the committee that we had any disagreement on, and that was a friendly disagreement.

Then we had maybe one bill get out of committee that did not have bipartisan support, and that was a friendly disagreement. So this committee acts the way the Senate has to act if anything is to get done, and that is in a bipartisan way.

For people who might not understand why it takes bipartisanship in the Senate to get anything done, it is because of the filibuster and the protection of minority interests, the only institution of our political system where that is done, in the Senate of the United States. So, nothing gets done if just Republicans stick together and Democrats stick together. So if you want to get something passed, we get it passed.

I think that Senator Baucus is probably in the same vein of thought as a famous Senator from his State by the name of Mansfield, who thought the Senate ought to work and have product. I do not know whether that is where he gets his inspiration or not, but I know that that was a good pattern to follow.

Whether he recognizes it or not, I think he follows in that pattern, and we get a great deal done, with a great deal of cooperation. I guess I owe it to you to thank you for that cooperation, and wish you well over the next 2 years, hopefully. [Laughter.]

Senator BAUCUS. It has been a real pleasure.

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*For further information on this subject *see also* "Present Law and Background Relating to Tax Exemptions and Incentives for Higher Education," Joint Committee on Taxation staff report, December 4, 2006 (JCX–49–06); and "Higher Education Institutions: A Discussion of Organizational Status," Congressional Research Service, December 1, 2006.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Mr. Chairman, you kind of beat me to the punch here. I was going to compliment you right off the top. I do not know that the Senate has had a better Chairman, frankly, in many, many years that has been so cooperative. It has been just a joy to have this partnership, the two of us working together.

This is probably going to be your last hearing of this Congress, but I want you to know that we are going to have the same partnership in the next Congress. "Joy" is the word. It has just been a real reward for me to work with you in the vein that you just described. It means a lot to me. And it will continue in exactly the same way.

The CHAIRMAN. Thank you very much.

Senator BAUCUS. Mr. Chairman, I am excited that we are having this hearing on education. We all know the importance of education. I am going to spend a lot of my time in this Congress—what is left of it—and in the next Congress helping to advance the cause of education in our country. It is critical.

Aristotle once said that legislators should spend their time helping to educate youth. He was right. We all know today that we must as well.

I have introduced legislation to try to advance education in our country. It is a bit ambitious. It is meant to be a bit controversial, because I think we have to stir up a little controversy to, frankly, get our country focused much more, and more effectively, on education than we have in the past.

One small anecdote. It really does not mean a lot, but maybe it means something. I took a bunch of Montana businessmen over to India earlier this year. When we were in Bangalore, I spent some time at the Jack Welsh Technology Center. That is a GE research center there in Bangalore.

At the end of the tour, I asked the manager, "Why are you here? Why are you here in Bangalore?" He said, "The greatest talent pool is here." I said, "Well, in what country is the next greatest talent pool?" "China." "Well, where are we, the United States?" "Well, you are down there a little bit." "Well, what do we have to do to get up there?" He said, "Education. Education and health care costs. Your health care costs are too high, and you do not spend enough time on education in your country."

I know he is right. With the world getting increasingly globalized, complicated, interrelated, clearly a comparative advantage we might have in America is brain power, education.

Other people are just as smart as we, but we just have to take advantage of the creative opportunities in this country, the creative juices, the innovation in our country to tap into developing a world-class education system so that our kids and our grandkids can have the same quality of life that we have been able to have in our lives. I think it is bedrock, it is so important.

My legislation is just an idea, a start to advance the ball a little bit here, to give voluntary universal pre-kindergarten education for all Americans. Voluntary pre-kindergarten education for all Americans. States contribute, but I think you have to start young, really young.

Second, do not add that much more for elementary or secondary, except to suggest 100,000 scholarships for teachers who want to go into math, science, engineering, and into teaching. If they get more people more involved in teaching, particularly in the core subjects, that makes a lot of sense.

I also suggest in the legislation to give free tuition, college-level, for anyone who majors in math, science, or engineering so long as that person gives back 4 years working at a company, an institution in that field, or teaching in that field, a little bit like the Peace Corps concept. I am just trying to figure out ways to help encourage people to train in those subjects.

Increasing the Pell grant up to $6,000 is another idea I had. There are some after-school provisions, because people tend to fall through the cracks a little bit and need some help in that regard. Also, to simplify the tax code when it comes to education. I think there are two many different things. There is the HOPE scholarship, lifetime, and so forth. It gets a little complicated for people, I think, sometimes.

But simplify that and make it very significant so that people who do have income can get a tax deduction. But on the other hand, you have to increase the Pell grant because a lot of people just do not have the income.

In my State of Montana, for example, 80 percent of college students get financial aid. Eighty percent. I think the national average is about two-thirds. We really need to help them get to college. I am really happy that we have all six of you on this panel here this morning because one of your focuses was on access, how to get to college.

I know it is an extremely complicated subject, but I just, Mr. Chairman, want you to know that I am going to spend a lot of my time on this subject, because I think it is just so important for our country.

We have to start thinking more strategically in America. We react too much here in the Congress with this issue, that issue, on almost a daily basis. I hope that our country can, next year, start again thinking a little more strategically, spending more time laying the foundation to help our country be more competitive.

Education is clearly key, but it is also in energy, health care costs, and so forth. Let us start tackling the basics and think more strategically, plan a little more with some outcomes, some metrics to see how we are doing, kind of measure how we are doing, like a good businessman.

In a certain sense, we in the Congress are charged with being kind of a CEO of the country. We have to start building some plans here, figuring out what is working, what is not working, so that our kids and our grandkids have the same opportunities on down the road that we have.

Otherwise, I am afraid we will kind of slowly fritter away, just slowly, slowly, slowly fritter away in this country. We have super opportunities. The big advantages we have in America are our ingenuity, our creativity, and our free enterprise, which help make that happen.

Mr. Chairman, I again thank you for this hearing. I want to end where I began: I just cannot thank you enough for your partnership and the relationship we had working together.

The CHAIRMAN. Thank you. It has been very enjoyable, and will continue to be enjoyable.

[The prepared statement of Senator Baucus appears in the appendix.]

The CHAIRMAN. Before I introduce the panel, if I slip out just for a few minutes, I am going to ask Senator Baucus to chair, because I have to go down the hall here to ask questions at the appropriate time of one of the witnesses before the Judiciary Committee.

The first witness is Mr. Daniel Golden, deputy chief, Boston bureau, *The Wall Street Journal;* then Dr. Bridget Terry Long, associate professor of education and economics, Harvard Graduate School of Education; Dr. James Johnson Duderstadt, president emeritus and professor of science and engineering, University of Michigan.

Then we have Patricia McGuire, president of Trinity University in Washington, DC. Ms. McGuire has served on the Red Cross Review Board. I mention that today because I am going to be introducing legislation based on the work of that board. Obviously, as I thanked you over the phone, I thank you publicly now for your hard work in that area and taking a very responsible approach.

Then Dr. Susan Dynarski, associate professor of public policy, John F. Kennedy School of Government, Harvard; and, last, Mr. Michael Brostek, Director, Tax Issues, Strategic Issues Team, U.S. Government Accountability Office.

Mr. Golden? By the way, for all of you, your longer statements will be put in the record, so you will not have to ask for permission to do that.

STATEMENT OF DANIEL GOLDEN, DEPUTY BUREAU CHIEF, BOSTON BUREAU, *THE WALL STREET JOURNAL,* BOSTON, MA

Mr. GOLDEN. Thank you. Good morning, Mr. Chairman and members of the committee. My name is Dan Golden. I am the deputy chief of *The Wall Street Journal*'s Boston bureau, where I cover education.

I am also the author of the recently published book, "The Price of Admission," which reveals the extent of admissions preferences for wealthy and well-connected applicants at the Ivy leagues, Duke, Stanford, Notre Dame, the University of Virginia, and other leading colleges. Thank you for inviting me to testify.

My research demonstrates that elite colleges and universities use admissions to generate revenue, enhancing their massive endowments. Their favoritism toward the wealthy undermines equal opportunity and upward mobility in our society.

I found that four major preferences favor affluent candidates in admissions to selective private and public universities. I estimate that nearly one-third of the students admitted to some elite colleges receive special consideration due to what I call "preferences of privilege" far more than those who enjoy an edge due to affirmative action.

The first such preference is for alumni children, who make up about 10 to 25 percent of the student body at elite colleges. Leg-

acies, as they are called, gain admission at 2 to 4 times the overall rate. I estimate that legacy applicants enjoy a 50- to 75-point advantage on the old 1,600-point SAT scale over students who do not receive any preference, and more if their parent is a major donor.

The second preference of privilege favors what are called "development cases." That is a euphemism for applicants recommended by the fundraising or development office because, if they are admitted, their non-alumni parents are expected to provide money or visibility. The preference for these children may amount to as much as 300 to 400 SAT points out of 1,600.

The third preference of privilege helps athletes in blue-blood sports. Viewers of college basketball and football on television assume that college sports are racially and economically diverse.

What they do not realize is that colleges also give admissions breaks to athletes in many prep school sports that most American children rarely have a chance to play, such as crew, horseback riding, sailing, squash, and even polo. Athletes in many of these sports also enjoy full scholarships, despite their wealth.

The last preference of privilege benefits children of university faculty and administrators. At many institutions, these children receive both an admissions break and free tuition.

These advantages are linked. College admissions officers often lower standards for these children because they do not want to incur the wrath of fellow administrators and faculty members forced to pay full tuition elsewhere. Children of a college's own faculty and administrators often comprise 2 to 3 percent of the student body at these national institutions.

The preferences for the privileged directly exclude highly talented candidates who are not wealthy or connected. When colleges lower the bar to admit privileged children, they make room by turning away outstanding middle-class and working-class applicants, predominantly white and Asian-American.

As Notre Dame's admissions dean told me, "The poor schmuck who has to get in on his own has to walk on water." Colleges contend that these admissions preferences are needed to elicit donations to support laboratories, scholarships, faculty salaries, and other expenditures.

Certainly I believe these are worthy causes, but I wonder how much more money colleges need with Harvard's endowment at $29 billion or so, Yale's at $18 billion, and so on down the line.

I also believe that raising money by compromising the admissions process is not the only way for elite colleges to maintain quality. In my book, I profile three excellent institutions: the California Institute of Technology, Berea College in Berea, KY, and the Cooper Union for the Advancement of Science and Art in New York City, which admits students purely on merit, yet they have amassed ample endowments on the basis of innovative fundraising and compelling missions.

Public universities clearly have an obligation to provide educational opportunity to students of all backgrounds, but the nonprofit, tax-exempt status of America's elite private colleges also confers on them a social responsibility to broaden access.

Reflecting this mission, such colleges describe themselves as "need blind," meaning that admissions decisions do not take into

account a candidate's need for financial aid. But the finding of my research is that, even if colleges are "need blind," they are not "wealth blind." That is, they offer advantages to the wealthy and well-connected in admissions, to the detriment of young people of outstanding talent born to less well-off or prominent parents.

I would encourage America's elite universities to eliminate these preferences of privilege and open their doors to the best applicants, regardless of wealth. Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Golden appears in the appendix.]

The CHAIRMAN. Now, Dr. Long?

STATEMENT OF DR. BRIDGET TERRY LONG, ASSOCIATE PROFESSOR OF EDUCATION AND ECONOMICS, HARVARD UNIVERSITY, CAMBRIDGE, MA

Dr. LONG. Good morning, Mr. Chairman and committee members. Thank you very much for allowing me to speak to you this morning.

I have been doing research on issues of college access and affordability for over 10 years now, and I am going to share some of the results of that research, along with other colleagues.

First, to put in perspective, the types of institutions we have just heard about really only cater to about 3 or 4 percent of students; the top institutions that have those large endowments that we see in the press really only cater to about 1 percent of students. So, I am going to speak more generally about what we see in terms of college behavior.

So as we consider tax breaks and financial aid, let us first consider how colleges set their tuition prices. A major question is whether or not colleges are reacting to Federal financial aid and raising their tuition prices in response.

The concern is obvious. If we are creating these policies and colleges are then bidding up their prices, the discount in benefits to students are going to be bid away. So, there are very important implications in terms of student affordability, as well as how we efficiently decide to use our tax revenues.

So how do we know if colleges are responding to prices? Well, clearly, tuition prices have increased dramatically in the last several decades. But just because tuition prices have increased at the same time that financial aid revenues and expenditures have increased does not mean that one is causing the other.

We must take this analysis a step further to isolate what is the impact of financial aid versus the many other factors that impact college tuition pricing, such as declining State appropriations and increased expenditures on technology and student academic supports.

So what part of the puzzle is due to Federal financial aid and what part is due to other reasons why we might expect tuition to increase over time, regardless of whether there is financial aid? What does the evidence say?

To summarize, there is no smoking gun in terms of evidence that says colleges are reacting to Federal student aid by raising their prices. Most studies show little to no response by institutions.

So, for example, I completed a study in 2004 that looked specifically at the higher education tax credits. I found that public 4-year institutions and private institutions were not responding at all.

In terms of the community colleges, there was some mixed results. Some results pointed to positive results. Other results, though, pointed the other way, that community colleges may have actually been reducing their prices in response to the credits.

So while most studies find little to no response in terms of college behavior, studies that find some evidence often have conflicting results that are very weak, that are not robust, and that no researcher would use to state definitive claims that colleges are reacting.

I would like to say, though, as we consider this issue, it is much more important that we shift our focus from the list tuition prices that colleges have in their catalogues to the net tuition prices that students actually face.

So in my slides, if you will look at what has happened to prices at public 4-year institutions over time, if we look at their catalog prices, they have increased 49 percent from 1996 to 2006, but when we look at net price, the increase has only been 29 percent. As the bar graph shows, the price that is listed in the catalog is much higher than the prices that students actually pay. This is also true for private institutions.

So we need to push our analysis further and our discussions further, not focusing on that list price, but instead that net price. It is a much better indicator of college behavior and how they might be reacting to financial aid policy.

In fact, one study by Michael MacPherson and Morton Schapiro in 1991 shows that, when Federal financial aid was increased, private institutions actually increased their institutional aid as if to further reduce the costs for students.

We certainly need more information on net price so we can have a better handle on what colleges are doing, but it gives us a better sense of their behavior, as well as true affordability for students.

So if aid is not driving up college tuition prices, why have tuition prices increased so much in recent decades? Well, I already briefly mentioned State appropriations. As my slides show, we can see that as State appropriations have fallen, tuition has very closely mirrored the increase. Public institutions have had to make up the difference in other ways.

There are also increasing costs for faculty as the faculty ages and are now baby boomers at the peak of their earnings capacity. There have been plenty of new expenditures on technology and student services.

We also should not forget that those huge expenditures on institutional aid are also part of the reason why tuition prices have gone up, so we need to identify best practices and how colleges are trying to keep prices low, but realize that there are valid reasons why tuition prices have gone up.

So to close, as we do reconsider financial aid, there again is no smoking gun to suggest colleges are raising their tuition prices due to Federal aid, but there is very good data, very good numbers to say there is a large unmet need. We need to simplify our policies

and refocus on students who need our help in order to be able to attend college.

Thank you.

The CHAIRMAN. Thank you, Dr. Long.

[The prepared statement of Dr. Long appears in the appendix.]

The CHAIRMAN. Now, Dr. Duderstadt?

STATEMENT OF DR. JAMES JOHNSON DUDERSTADT, PRESIDENT EMERITUS AND PROFESSOR OF SCIENCE AND ENGINEERING, UNIVERSITY OF MICHIGAN, ANN ARBOR, MI

Dr. DUDERSTADT. Thank you, Mr. Chairman and members of the committee.

For the last year, I served as a member of the Secretary of Education's National Commission on the Future of Higher Education in America, and I thought I would put two or three of our most significant findings on the table that relate to the matters before this committee.

First, we found that, while in today's global knowledge-driven economy a college education is more important than ever, too few Americans have that opportunity.

There is ample evidence that qualified young people from families of modest means and minority groups are far less likely to attend college than their affluent peers. Today's students from the highest income quartile are over 10 times more likely to attend, and graduate, from 4-year colleges than those from the lowest quartile.

Second, the manner in which we finance higher education in America is under increasing strain as institutional costs continue to rise, State support for public universities continues to decline, and the tuition and debt burdens on our students continue to soar.

Third, our financial aid programs at the Federal, State, and institutional level are not only confusing and complex, but they fail to address adequately the needs of low- and middle-income students. Key here has been the shift of Federal programs over the past several decades from an emphasis on need-based grants to subsidized loans to tax benefits, even as States and institutions have increasingly emphasized merit-based over need-based financial aid.

Now, many of the answers to these dilemmas lie within the jurisdiction of other committees of Congress, but Federal tax policy can, and does, play a role in the support of higher education.

Current tax policies both assist parents in saving and paying for a college education for their children, and they also provide strong incentives for donors to contribute to a variety of purposes in higher education.

But while most of these tax benefits contribute substantially to our colleges and to education, some have drifted rather far from the tax-exempt purposes of education and scholarships.

As some of you know, I have written in the past about my concerns about intercollegiate athletics and argue that tax policy, to some degree, is fueling an arms race in stadium construction, coaching salaries, and, indeed, even in student exploitation in big-time sports programs such as college football and men's basketball.

Now, to be sure, Federal tax policy helps create a balance between public and private support that has been key to the diversity and the quality of American higher education that is very much envied by the rest of the world.

But what our tax and student aid policy does not do as well as it should is to assure that help is directed at students with the greatest financial need so that they can attend college.

The challenge seems clear. How do we make sure we provide the right tax structure to go along with broader educational policy changes that will assure the access and affordability for higher education for the millions of Americans who need financial help?

It is imperative, both as a matter of social justice and economic competitiveness, that our Nation address and remove those factors that have created a strong dependence of access and success in higher education upon socioeconomic status, while at the same time sustaining America's leadership in higher education.

Mr. Chairman, as you begin to look at tax policy broadly in the next Congress, it is important that this committee look at partnering with the Committee on Health, Education, Labor, and Pensions, and other relevant Senate committees, in determining the proper role for tax policy to play in making sure that more American students can attend and succeed in college.

There are others on this panel with more policy experience than I have who may be able to suggest creative new ways to use our tax system so that more Americans can achieve greater skills and ability through higher education.

But I can state that the higher education community would welcome the opportunity to explore these and other ideas with the committee. Working together, we can begin to tackle these issues that will enable all Americans to benefit from educational opportunity and, in the long run, will determine the very future of America's economic and national security.

Thank you very much.

The CHAIRMAN. Thank you very much.

[The prepared statement of Dr. Duderstadt appears in the appendix.]

The CHAIRMAN. Now, Ms. McGuire?

STATEMENT OF PATRICIA McGUIRE, PRESIDENT, TRINITY (WASHINGTON) UNIVERSITY, WASHINGTON, DC

Ms. MCGUIRE. Thank you, Senator Grassley, and thank you for your very kind remarks earlier. It was an honor to serve on the Red Cross Governance Advisory Board.

Trinity is pleased to be part of congressional history. Our alumna, Nancy Pelosi, is about to become the first woman Speaker of the House, so we proudly congratulate her.

Trinity has changed a lot since Speaker Pelosi graduated in 1962. Today, we enroll more District of Columbia residents than any other private university in the Nation. Nearly half of our students are DC residents. Nearly 90 percent of students are black or Hispanic.

More than 95 percent are low-income students from the eastern quadrants of the city, who receive substantial unfunded tuition dis-

counts. Indeed, our discount is 40 percent, on average. More than half of our students are eligible for Pell grants.

Our full-time tuition this year is $17,700. And, by the way, we have not raised our tuition more than 3 percent in any year in the 18 years that I have been president, but I do not know of any student who pays $17,700. The typical Trinity student pays about $2,000 or less out-of-pocket after all aid is awarded.

Like half of all private colleges today, Trinity's endowment is less than $17 million. Indeed, our endowment is about $10 million. In many ways, Trinity is no different from the majority of small, private colleges and universities that do some of the most effective educational work in this Nation.

Regulatory behaviors aimed at a very few elite institutions will have a much more harmful effect on us. Harvard will barely feel the pinprick of a policy that could put us out of business, literally.

The Federal tax-exemption for education recognizes the public good that colleges contribute to this Nation. We are drivers of economic prosperity. In 2004, private colleges and universities employed nearly a million people nationwide and had a cumulative impact of more than $340 billion on our local economies. The tax-exemption is essential to this economic engine for our communities.

Harvard's endowment is extraordinary, yes, but put that in perspective. At the end of fiscal year 2005, there were more than 1,300 private colleges and universities in this Nation. The median—half below this—for these institutions was $16.3 million. Only 38 out of 1,300-plus schools reported endowments of more than $1 billion.

Regarding the compensation of presidents, of 670 private colleges listed on the recent survey in *The Chronicle of Higher Education,* 60 percent had salaries of less than $300,000, and 27 percent were less than $200,000, and that includes me, and I have been president for 18 years.

Regarding tuition, of 1,200 private colleges and universities, the average tuition is $22,000, but given the prevalence of tuition discounts, the actual cost to a student at a private college is much less, on average about $13,000. By the way, students attending private colleges and universities receive 5 times more grant aid from their institutions than Federal subsidies.

There are deep historical roots to the wealth of Harvard and similar institutions. I should also note that the creation of wealth is considered the ultimate expression of good fiduciary duty. It is the paradox of these hearings that serving fiduciary duty also creates a paradox in terms of access and affordability.

Strong endowments are part of the creditworthiness of institutions. The standards that Moody's and other credit rating agencies apply often work in conflict with the values of access and affordability.

Consider this from Moody's 2006 Private College and University Medians: key credit strengths of an institution include strong growth of net tuition per student, which means higher tuition and less discount, and a challenge includes heightened external scrutiny of higher education tuition affordability, raising concerns about future continued growth of net tuition per student.

Moody's takes a dim view of institutional practices that repress tuition growth, while providing greater access to needy students. At

Trinity, when we were in the process of securing our first-ever credit rating, we were advised that our lower tuition price and our large volume of minority students would have a substantial negative impact on our credit rating.

Charitable gift support is supported by the policy of tax exemption. It is important to realize that charitable gifts are essential to keep our tuition down. Many students and families do not realize the tuition they pay covers only part of the actual cost of the student's education. In the typical private college, tuition pays only about 50 to 75 percent of the total cost of education.

Now, what can Congress do about all of this? Thousands and thousands of more low-income students nationally will benefit if Congress, in its wisdom, will increase the maximum Pell grant, which has not grown for 5 years. Middle-income families, similarly, continue to need the support of tax incentives to help offset their college expenses.

As Dr. Long already indicated and other studies have said, these kinds of subsidies do not drive up tuition increases. Tuition does increase for many other reasons, but it is not a factor of Federal financial aid.

Thank you so much for your attention today.

The CHAIRMAN. Thank you.

[The prepared statement of Ms. McGuire appears in the appendix.]

The CHAIRMAN. Dr. Dynarski?

STATEMENT OF DR. SUSAN M. DYNARSKI, ASSOCIATE PROFESSOR OF PUBLIC POLICY, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY, CAMBRIDGE, MA

Dr. DYNARSKI. Mr. Chairman and members of the committee, I am honored to have the opportunity to testify before you today.

First let me say that a college education is an excellent investment. Over his lifetime, a worker with a bachelor's degree earns, on average, $1 million more than a less-educated worker.

But college remains out of reach for many. A third of white, non-Hispanics earn a B.A., but only 13 percent of African-Americans and 8 percent of Hispanics earn a B.A. Even among the smartest kids, income strongly predicts college attendance. If you are a smart and poor kid, odds are you will not go to college. The odds are one in three. If you are a smart and rich kid, odds are you will go to college, three out of four.

I give you these statistics to get us thinking about our goals for the education tax incentives. Whether they have been a success after all depends on what goals we are setting for them.

If our goal is to ease the pinch of college costs for upper-income families whose children attend expensive private schools, then the tax incentives do a passable job. I would give them a "C." If you are familiar with grade inflation at Harvard, you will know that "C" is faint praise from a professor.

But I believe we have somewhat more ambitious goals for the tax incentives. We want to increase the skills of our workforce. We want to maintain America's competitive edge in the global economy. We want to make college a reality for those smart, but poor kids who believe it is out of their reach.

So if these are our goals, then the tax incentives get an "F." It is not that they are a bad idea: make college cheaper with a tax credit and more kids should go to college. It is very simple economics.

But it is also simple economics that a subsidy will increase schooling only if it reduces prices for those for whom price is a barrier. We need to get money into the hands of those who are just teetering on the threshold of college and need a helping hand from us.

Who are these potential college students? They are from low-income families, and they are disproportionately non-white and Hispanic. Where might they go to school? The local community college, where tuition and fees average $2,200 a year, or a State university, where they average $5,500 a year.

I want to drive this point home with a picture. There is a graph in my testimony that shows average tuition and fees in the United States. At the top of this graph are the Dennisons, the Harvards, the Williamses, where costs average above $20,000 a year. A minority of students attend these elite institutions.

If you look down, down, down, you will see tuition at schools attended by the typical student. Eighty percent of students attend schools with tuition and fees below $10,000.

Senator BAUCUS. We just found the graph. Could you go through that again?

Dr. DYNARSKI. All right. That top graph.

Senator BAUCUS. Figure 1?

Dr. DYNARSKI. Exactly. That top line is the elite schools: private, 4-year schools where tuition is above $20,000 a year, on average. That is a minority of students. About 20 percent of students are going to those schools.

Down at the bottom, are the 80 percent of students, with an average of $2,200 a year for the community colleges, $5,500 a year for the 4-year public schools. And that is the list price. As was pointed out by Dr. Long, the net price is actually about half of that.

So this is who we should keep very firmly in mind as we are thinking about the tax incentives and how they should be designed. We should be thinking of a low-income person attending an inexpensive public college.

The student who is admitted to Yale, or Williams, or Dennison whose family earns $100,000 a year is going to college whether we give him a tax incentive or not, and we should not be building our education policy around the prices that she faces.

As currently designed, the education tax incentives do just about nothing for the target population I just described. Instead, the tax incentives focus on upper-income students at the most expensive private colleges.

There are three problems with the targeting of the tax incentives. First, they are non-refundable. Half of the families with college students do not get the full credit because their income and their tax liability is just too low.

Second, the full value of the Lifetime Learning Credit does not even kick in until tuition and fees exceed $10,000 a year. As I pointed out, for very few students is that the case.

Third, the now-expired tuition deduction was most valuable in the upper tax brackets. Over half of the benefits of this deduction accrued to households with incomes over $100,000 a year. Children from these families are going to college with or without our help.

In addition to being poorly targeted, the tax incentives are too complicated and confusing to do their job. Families cannot respond to a price subsidy if they do not get it. Those on the margin of college entry are low-income, non-white or Hispanic, with parents who did not go to college. English might be the second language.

From this context, think about the tax incentives: the IRS Publication 970 which explains the tax incentives is 82 pages long. Research shows that complicated programs like these do not affect college attendance. Simple, easily communicated subsidy programs do increase college attendance and completion.

To make the tax incentives for education more effective, we need to focus and simplify them. We should focus them on people who need them and simplify them so that families can understand them and respond to them.

So, I recommend we create a single refundable tax credit. A single credit would reduce complexity. Making it refundable would get it into the hands of people who need it.

Second, I recommend that we deliver the credit at the time of college enrollment when people need it, when tuition is due, and not a year later when taxes are filed. The Department of Education manages to deliver grants at the time of college enrollment, so this can be done.

We could go even further by consolidating the tax credits and the Pell grant into a single simple and generous grant for college students. College students and their families now face two parallel and duplicative bureaucracies, a tax system and a financial aid system. To consolidate the process into one tax credit and one application, that is less paperwork and less headaches for American families.

Such a simple program could easily be communicated to families. We right now send workers estimates of their Social Security benefits so they can plan for retirement. Let's send families estimates of the education credit so they can plan for college.

Early and clear information gives families confidence they can afford college, and encourages their children to do their part by working hard in elementary school and high school.

So to close, the education tax benefits do not, as they are now constituted, get more people into college. Simplifying and focusing the incentives will allow them to serve their goal, just opening the doors of college to those who have the ability, but not the means, to further their education.

Thank you.

The CHAIRMAN. Thank you, Dr. Dynarski.

[The prepared statement of Dr. Dynarski appears in the appendix.]

The CHAIRMAN. Mr. Brostek?

STATEMENT OF MICHAEL BROSTEK, DIRECTOR, TAX ISSUES, STRATEGIC ISSUES TEAM, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Mr. BROSTEK. Mr. Chairman, Senator Baucus, and members of the committee, thank you for the opportunity to testify today on the Federal Government's efforts to financially support attendance at post-secondary education institutions.

American higher education has long been crucial to the development of our Nation's cultural, social, and economic capital. This hearing is an opportunity to consider whether any changes should be made in the government's overall strategy for providing such assistance, or to the individual programs and tax provisions that provide the assistance.

This is important for several reasons. The fact that we face large and growing structural deficits in the future, primarily driven by demographics and rising health care costs, emphasizes the need to consider how government allocates its resources.

In addition, GAO has noted that fundamental reexamination of government programs, policies, and priorities is necessary to ensure that they match 21st-century needs.

My statement today focuses on three issues: differences between tax preferences and title IV assistance; apparent ineffective use of tax preferences, possibly due to their complexity; and the lack of research about the effectiveness of education-related tax preferences and title IV programs.

Post-secondary student financial assistance provided through programs authorized under title IV in the tax code differs in three important ways. First, title IV grant and loan programs traditionally provide aid to students while the students are in college. Tax preferences help then, but they also help students and families save before college and help in repaying college costs after college.

Next, while student aid programs and tax preferences serve students and families across a wide range of income groups, some title IV programs, we have heard, particularly the Pell grant program, provide much of their financial assistance to students in families with lower incomes.

For instance, for Pell grants to independent students, 92 percent of the dollars went to families with incomes of $40,000 or less in the 2003–2004 school year. In contrast, over half of the dollar benefit provided to tax filers under the tuition deduction went to those with incomes of more than $80,000.

A final difference between title IV programs and tax preferences involves students' and families' responsibilities. Students and families have more responsibility for appropriately using the benefits of tax preferences compared to title IV aid.

For title IV aid, students and families fill out the Free Application for Federal Student Aid form, albeit complex, and submit it to the Department of Education, and then Education is responsible for calculating the student's and family's expected family contribution. Then students' educational institutions are responsible for determining eligibility and the amounts and packaging of award amounts to students.

In contrast, for users of the tax benefits, they must identify the applicable preferences, understand the rules, understand how these

preferences interact with each other and with the Federal student aid system, keep records sufficient to support filing of their taxes, and correctly claim the credit or deduction on their return.

Post-secondary education preferences can be difficult for families to understand and use correctly. Perhaps due to the complexity of the tax provisions, hundreds of thousands of taxpayers failed to claim tax benefits that they are entitled to, or did not claim tax benefits that would be most advantageous to them.

For example, we estimated that in tax year 2002, nearly 450,000 taxpayers either failed to claim an education credit or to take a tuition deduction to which they were entitled, or used one tax provision when another would have been more beneficial to them. About half of those taxpayers who made suboptimal choices used paid preparers.

Finally, when we did our work in 2005, we found that Congress has received relatively little evidence concerning the effectiveness of the assistance provided under either the title IV or the tax preferences in promoting, for example, attendance at college or choice.

In our report, we found no research on any aspect of effectiveness for several major title IV programs and tax preferences. For example, no research has examined the effects of Federal post-secondary education tax credits on students' persistence in their studies or on the type of educational institution they chose to attend.

Gaps in the research on post-secondary education program effectiveness may be due, in part, to data and methodological problems that have proven difficult to overcome. The relative newness of the tax preferences also presents challenges because relevant data are, in some cases, just becoming available.

This concludes my oral statement. I would be happy to answer questions.

[The prepared statement of Mr. Brostek appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Brostek, very much. I particularly appreciate everybody staying within the time slot that we gave to each of you.

We will have 5-minute rounds, and this will be the order: Grassley, Baucus, Thomas, Bingaman, Bunning, Schumer, and Lincoln.

Mr. Golden, your book says that the preferences at our Nation's top universities provide to those who are children of alumni, who are children of faculty, and perhaps most incredibly, those who are children of the wealthy.

Are you aware of these top universities providing the same level or number of preferences for those who served in the armed forces, like serving in Iraq and Afghanistan?

Mr. GOLDEN. I am not aware of those type of efforts. Many years ago, after World War II of course, the GI bill was responsible for a large influx of veterans into elite colleges, as well as other education. I am not familiar with any kind of similar large-scale influx today.

As I describe, what I am aware of is an extensive system of preferences for children of the wealthy and alumni and others. I am also aware of recruiting efforts by colleges that seek to boost their endowments by recruiting, not in Iraq, but at American prep

schools and other elite high schools in order to find financially wealthy candidates.

The CHAIRMAN. Well, I think we all have some concern about preferences that give advantages to the wealthy and do not take into consideration the needs of those who have fought to defend our Nation and our freedoms.

For you and anybody else on the panel—but because of time not too many other people, though I do not want to leave anybody out who wants to comment—two questions. I am going to ask Mr. Golden to answer first. I want to state both questions so I do not take as much time.

I know that a few elite universities have recently trumpeted that they are providing tuition tax-free for low-income individuals. However, Mr. Golden, I am worried about whether this is really expanding access for low- and middle-income families or if it really is just changing the mix, given the significant number of individuals that are being admitted under special cases, such as children of alumni and children of the wealthy.

Are these actions more about public relations as opposed to actually increasing the number of middle-income and low-income families that are going to be actually admitted into the top universities in the first place?

The second question. I know that many universities are going to tell me, if they have not already, that they provide institutional support and assistance for working families.

However, I have also read accounts which suggest that the amount of this institutional assistance has gone down in recent years, perhaps—but not for sure—in response to government efforts to increase aid, but that also a great deal of the institutional assistance at elite colleges also goes to wealthy families. Your views, then anybody else who wants to comment on it.

Mr. GOLDEN. Yes. As you say, a number of top colleges, Harvard and others, now provide free tuition to families under a certain income level. At Harvard, it is $60,000. I regard these initiatives as promising and a step in the right direction.

My concern would be that, because they have not indicated any reduction in the preferences that I speak of for alumni children, donors' children, and so on, essentially the increased number of slots they may provide to children of low-income families will essentially come at the expense of middle-class families, so they appear to be pitting low-income and middle-income families against each other rather than cutting into the slots for the rich which they appear to regard as sacrosanct.

In regard to the second question—institutional aid—I do not have as much expertise on how that is broken down, but I would note that a large part of higher education institutional aid is provided in the form of athletic scholarships, not in the Ivy league, which just has need-based scholarships, but elsewhere. Often, as I document in my book, athletic scholarships go to relatively affluent students.

There are a number of studies showing that athletes at liberal arts colleges actually come from wealthier families than the average student, in part because they are playing sports that are predominantly played at prep schools and elsewhere.

There has also been, in the area of aid, a move toward greater merit aid, which also favors affluent families. But that is not sort of in my area of expertise, but I am sure others on the panel can speak to it.

The CHAIRMAN. All right. I will ask you three to comment shortly, please, because I do not have much time left. I will not ask another question before I go to Senator Baucus.

Dr. Long, then Dr. Duderstadt, then Ms. McGuire.

Dr. LONG. Thank you, Mr. Chairman.

Just briefly, you mentioned the low-income initiatives that schools like Harvard and Princeton University have. I would also like to recognize schools like the University of North Carolina at Chapel Hill, where they are reaching out to low-income students.

They have found that their applications have gone up and they have coupled these scholarship programs with intensive recruitment activities to find students who might not think that they can afford Harvard, but to let them know that there is financial aid available.

So, they have seen an increase in their enrollment of low-income students, and it does seem to be changing—at least at Harvard—the face of the institution.

I will also briefly say that institutional aid expenditures from colleges and universities are actually increasing and continue to increase but, yes, there are concerns.

Some institutions are using this money for low-income students, particularly at the top—they only give need-based financial aid—while other institutions are using this for merit, which is favoring more affluent families. They are really balancing multiple goals. So, I suggest that we need to have more information about exactly how they are awarding this institutional financial aid. Thank you.

Dr. DUDERSTADT. I would like to make a comment, very quickly, about the recent study by the Educational Trust that Kati Haycock put before us about the tendency of the 50 flagship public research universities that are seeing an increasing shift away from the broad populations that they were founded to serve to more affluent students.

In part, that is because of a decline in State support, but it is also a conscious effort on the part of many of these institutions to shift from institutional need-based to merit-based aid, primarily to pump up their rankings in surveys such as *U.S. News & World Report,* which of course give much higher weight to student grade point averages, class rank, and standardized test scores.

I think part of the difficulty here is, these institutions need to look within themselves and understand more clearly just what the socioeconomic distribution of their student bodies is, because the concern is, as public institutions, they are beginning to drift away from their public purpose.

The CHAIRMAN. Ms. McGuire?

Ms. MCGUIRE. Yes. Thank you. Following on that, it is simply not true that support for needy students in private colleges and universities is declining. In fact, the reverse is true. It is growing quite rapidly.

I know at Trinity, our support has grown by more than 500 percent over the last 10 years for very needy students. It also is true

that the flagship State universities are educating a proportionately significantly wealthier population than many of the smaller private colleges, particularly in urban centers. There was a newspaper article in the *Washington Post* a while back that talked about the fact that, at the University of Virginia, the median family income was around $94,000. That was about 5 years ago; it is probably higher today. At Trinity, it is $35,000. Today our median family income is about $38,000.

You can bet that the gap between us and the University or Virginia or College Park is true for many of the smaller independent colleges and universities, particularly those that were founded by religious congregations in cities who see as our mission to educate, as a matter of social justice, those populations that have been historically excluded from higher education.

We do not have very large endowments because the good nuns and priests did not build large endowments; they worked for free in the past. We now have to pay our folks, but we also are providing massive support.

I know hundreds and hundreds of private colleges and universities that are discounting tuition at a rate of 40, 45, and even 50 percent, and it is at their peril.

The CHAIRMAN. I will insert in the record here something from the Lumina Foundation for Education entitled "Engines of Inequality." It says, "The average institutional grant aid to students from families earning over $100,000 annually—$3,823—is actually higher than the average grant awarded to low- or middle-income students."

[The information appears in the appendix on p. 178.]

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. Thank you.

I would be interested in the panel's reactions to the suggestion of Dr. Dynarski, namely, to maybe combine an increase in the Pell grant with a refundable tax credit and just make it simple for students.

Maybe, Dr. Dynarski, you can explain in a little more detail what your idea was. I would like for the rest of the panelists to respond to it.

Dr. DYNARSKI. First, I want to point out that the tax code is generally not a model of simplicity. [Laughter.] The education tax credits are no exception. But financial aid rivals the tax code in terms of its complexity.

The FAFSA, which is required to be filled out to get the Pell grant, has about as many questions on it as a complicated 1040. It is much more complicated than the typical tax form that somebody would be filling out given that they, say, make $30,000 a year. They would be filling out the 1040–A or the EZ, so the FAFSA is more complicated than taxes for them.

I would like to see both the financial aid system and the tax system for supporting higher education simplified, streamlined.

Senator BAUCUS. But your proposal was?

Dr. DYNARSKI. The proposal was to put them all together into one super credit. So, take the money that we spend on the Pell grant, take the money that we spend on the tax credits, put it all

together and have one unified credit that everybody is eligible to apply for.

Senator BAUCUS. And in a very short sentence, why is that a good idea? Then I want the rest of the panelists to respond whether they agree. Why is that a good idea, Dr. Dynarski? Tell me in your own words why it is a good idea.

Dr. DYNARSKI. It is simple. I think the people that we care about are those who believe that college is too expensive, so we want to deliver a simple message to people that college can be affordable.

Senator BAUCUS. And it is focused on less wealthy students and families.

Dr. DYNARSKI. Exactly.

Senator BAUCUS. All right.

Dr. DYNARSKI. So it is unifying into one program the low-income students who get the Pell, and the middle-income students who get the tax credits. Everybody is in the same boat.

Senator BAUCUS. All right. Ms. McGuire, your response?

Ms. MCGUIRE. I am in favor of anything that will simplify the ability of students to get Federal financial aid. It is absolutely a nightmare.

Senator BAUCUS. What about this idea?

Ms. MCGUIRE. Well, this idea has merit. However, let me answer that, for many of the lowest-income families that we serve in Trinity and elsewhere, the tax credit is not particularly useful.

Simplification is very useful, but for the majority of my students who are, in fact, independent even at age 18, the tax credit does not help them. They need the actual dollar support from the Pell.

Senator BAUCUS. But yours is refundable. She is talking about refundable.

Ms. MCGUIRE. They need to have the money when they enroll. They cannot wait.

Senator BAUCUS. That was her third idea. She mentioned that, too.

Ms. MCGUIRE. Well, that is fine. If it translates to real dollars at the time they enroll, the credits against the tuition price, then what the backdrop of that is, is transparent. But you have to remember, low-income students do not have the means to work through all of this, and that is partly what is discouraging them.

Senator BAUCUS. Sure. That is a good point.

Others' reactions? Dr. Long, you had your hand up. Either one.

Dr. DUDERSTADT. On the Spellings Commission, we actually had this delusion of grandeur: we could reduce the FAFSA down to a single page. Anything that simplifies the process and gets the dollars to students that have need, I think, is to the advantage of this country.

Senator BAUCUS. Now, what about this idea?

Dr. DUDERSTADT. I think it is a step in the right direction.

Senator BAUCUS. Would you modify it?

Dr. DUDERSTADT. I would have to look at it more in detail and I would have to get back to you on that. But I think, again, the effort to simplify and the effort to get dollars to the students that need them is the direction we have to be moving.

Senator BAUCUS. Thank you.

Dr. Long?

Dr. LONG. Yes. I think Dr. Dynarski's idea is a very good one. But to emphasize, there were three parts to it. You cannot just take the simplification and try to fold in the Pell grant program and use the credits as they currently are and expect to have an effect. It is key that it has to be refundable.

Work that I have done has shown that families that are most needy, the families and students we want to get into college, currently do not receive the tax credit. So if it is not refundable, we are going to be missing that part of the population.

Second, the issue of timing is vitally important. Work I did shows that the tax credit turned out to actually increase access, meaning new people coming to higher education. They are helping with affordability, but that is a slightly different issue.

If we actually want to have a single financial aid program that will increase enrollment, taking people into college, we have to be able to give them the money when they need to pay their tuition bill. So, those key things that Dr. Dynarski said, refundability and the timing, matter a great deal, along with simplicity, if we are going to put these two programs together.

Senator BAUCUS. Other reactions to the idea?

Mr. BROSTEK. We do not have an official position on it. We have not studied the issue.

Senator BAUCUS. No, neither have I. But it sounds like a good idea.

Mr. BROSTEK. Yes. It does sound to me like an idea worth exploring. Some things to consider in exploring it would include whether we were able to target the assistance to those who need it most through that process, what would be the tax administration impact of this?

A number of the lower-income individuals may not currently have a tax filing responsibility, given their income, so this would potentially bring more people into the system who would need to get used to using the tax system to receive this kind of assistance.

The issue of the timing, trying to make this advance payment, is an interesting idea. I think that deserves more study. From a tax administration perspective, if IRS gives someone money and then it turns out they are not eligible for it, it is difficult to recover that kind of outlay. That is particularly true, probably, for the lower-income taxpayers. So, I think that would need some study as well in deciding whether this is a good idea to go forward with here.

Senator BAUCUS. Thank you. My time has expired. Thank you very much.

The CHAIRMAN. I will skip over Senator Thomas. If he comes back, we will work him in. We will go to Mr. Bingaman, then, then Mr. Bunning.

Senator BINGAMAN. Thank you very much.

Let me just follow up on your last statement there, Mr. Brostek. You were saying, from a tax administration perspective, it is difficult to give money and then ever get it back.

Are there any examples? I am trying to think of examples where the government provides a tax credit or a payment based on a tax credit prior to the filing of the tax return. That is what is being suggested here, right?

Mr. BROSTEK. Well, there is a bit of an example. The Earned Income Credit has an advance option where you can get up to 60 percent of the credit that you would be eligible for in your paycheck during the year before you have to file your tax return.

I do not recall exactly how that is calculated. I believe it is based on your expected earnings for the year that you are entering into. There is this control of 60 percent eligibility because of the fear on many taxpayers' part that they might end up owing taxes, so that less than full eligibility is a means of trying to ensure that people do not end up owing taxes at the end of the year.

Senator BINGAMAN. Dr. Dynarski, let me ask you, your suggestion is that the single credit be a replacement for the grants, and the loans, and the deductions, and the credits that currently exist.

How would you—and I am sure there are actuaries around here who could tell us, or maybe just smart people who could tell us—translate a loan into a tax credit?

Dr. DYNARSKI. This is referring to the grants only right now.

Senator BINGAMAN. Oh. You would keep the Pell grant?

Dr. DYNARSKI. I would hang on to the——

Senator BINGAMAN. The Pell grants would be turned into tax credits, but the loans would continue to exist.

Dr. DYNARSKI. Correct. Correct. So basically you can, in a revenue neutral way—and for that matter, in a distributionally neutral way—just take all of these different programs that have different names and different application forms and different eligibility requirements and put them into one simple program.

You would just have to communicate one program to families, they would just have to apply for one program, and that lets you leverage the simplicity of the benefit, lets you go out and educate people about the benefit because it is a single program, and it lets people count on having money for college when their kids get to be of college age.

Senator BINGAMAN. Right. All right.

Well, I think doing some major simplification is very much to be desired, I would certainly agree with that. I think, also, getting the money to the people who need it or the tax benefit to the people who need it.

I think in my State you have an awful lot of these schools. I think you say nearly half the families with college students do not get the full credit because their income is too low. We have many people like that, of course, in my State. I think the tuition charged in many of the schools is so low in my State that you do not get the full benefit of the tax deduction or the credits.

One other aspect that I notice you also include in here relates to a bill that Senator Smith and I have introduced which would expand the availability of the deduction to not just tuition, but tuition, fees, and all sorts of other things that people incur.

Maybe you could just elaborate on that to some extent because, there again, I think that would help a lot of low-income people to get the benefit, particularly people who are going to inexpensive schools.

Dr. DYNARSKI. Right. So the deduction is limited to your net costs. The higher your tuition is, the greater the benefit of a deduction. If you go to a low-tuition school, a community college where

tuition might be $1,000, that limits the amount of tax benefit you can get right now.

If you include room and board, that starts to level the playing field because people at community colleges, while they are paying low tuitions, they do need to live, so, if they could deduct those expenses, that would get them more tax benefits.

I do have to say, though, that a deduction, by its nature, benefits people from the upper brackets more than people from the lower brackets. It is simply worth more, if you are in the 33 percent bracket, to deduct a dollar in income than if you are in the 10 percent bracket.

Senator BINGAMAN. Right.

Dr. DYNARSKI. So the tax credits, I think, are a more efficient way to get the money to the people who are really on the margin of going to college, but I think we need to be very clear about whether our goal is to get more people into college or to ease the pinch of costs for people who would go to college anyway.

Depending on which of those goals, you use a different tool. So if we just want to ease the pinch for people who were going to go anyway, a deduction might make sense. If we want to get into college people who cannot afford it and will not go if they do not get that credit, then we need to think about refundability and a tax credit. Those are the more proper mechanisms for that goal.

Senator BINGAMAN. So your suggestion is that this would then be administered out of two departments in the Federal Government. You would have the Department of Education still administering the loan program and you would have the IRS administering everything else.

Dr. DYNARSKI. I am an academic, right? You guys figure that out. [Laughter.] I think the IRS is best equipped to determine eligibility for all of these programs because they know people's income. You can determine eligibility for the loans and for the grants pretty easily once you know somebody's AGI.

The Department of Education has the delivery capacity in place because they deliver grants and loans to institutions right now. So it seems like you might have some system in which IRS is determining eligibility, and maybe Education would be delivering the grants to the institutions, as they do right now with the Pell grants.

Senator BINGAMAN. Mr. Brostek, did you have any thoughts as to how that might actually be done?

Mr. BROSTEK. Well, I would generally agree that IRS has some of the key information that would be needed to do this. As long as IRS has information that is verifiable from a third party, through information reporting from another party, they can be very accurate in ensuring that people are complying with the tax code and the tax credits are available.

A question would be whether there would be any additional information that IRS would need that it does not collect and whether or not that additional information could be verified by some other party.

Senator BAUCUS. What might that be?

Mr. BROSTEK. Well, the discussion about perhaps including room and board expenses is part of this for the tuition deduction. For

IRS, it would be very difficult to verify an independent student's rent that was being paid unless the landlord was willing to send in an information return.

If a lot of students were renting from fairly small landlord operations, that landlord may not be in the practice of sending out an information return that could be used to verify the expense that was being claimed.

Dr. DYNARSKI. And just to respond to that, in the realm of student aid, people do not verify the rent that they are paying. You set an allowance for what a student needs to live on in terms of room and board, and that allowance is what you would be able to put down on your taxes.

Senator BINGAMAN. Let me ask Mr. Brostek, is there any capability in the IRS to administer a loan program?

Mr. BROSTEK. Well, if you think of accelerated depreciation as being, in essence, a loan to a taxpayer on future tax considered due, I guess you could say the accelerated depreciation provisions in the Code are the equivalent of a loan. There is not another example that comes to my mind.

Senator BINGAMAN. All right.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you very much, Mr. Chairman.

Ms. McGuire, in your written testimony you address credit rating agencies and the pressure they put on colleges and universities. Could you comment on these issues? How, specifically, do these pressures influence decisions made by the university leaders?

Ms. MCGUIRE. Thank you so much, Senator Bunning, for asking that. I believe that it is a great deal of pressure. For many of my colleagues who are college and university presidents and trustees, the reality is that improving your credit rating is one of the number-one objectives you have, along with getting into the top tier of *U.S. News & World Report.* Both the credit ratings business and the collegiate rankings business, in fact, work against the very issues of affordability and access.

As I said earlier, and as I elaborate on in my written testimony, the reality is that colleges are small cities. All of us have buildings, some of which come from the 19th century and all the bad architecture of the 20th century. It all needs to be replaced. Our insurance companies are putting a lot of pressure on us, as a matter of risk management.

FASB is putting pressure on us this year. They have adopted a new rule, FIN 47, that requires us to reserve for asbestos liability. We never had to do that before, and it is running into the millions of dollars in some places. There is a tremendous amount of liability in the infrastructure. How do we address that? We address that through borrowing money.

But some institutions are more focused on borrowing more money at less expense, and that is what the credit ratings business is all about. So the better your credit rating, the cheaper the money is and the more you can borrow.

The problem is, it works against many of the other values that are on the table in this hearing because the reality is, for some of us who are serving the poorest of the poor, the most low-income students possible, getting a good credit rating is very, very hard be-

cause Moody's, Standard & Poor's, the investor rating services, see that as a tremendous risk. What is the risk? That we will not be able to pay back the loan, of course. Now, is that a sensible view for them to have? Probably. That is a sensible banking point of view.

One of the problems is, in the past, in the 1950s, the 1960s, and so forth, there were tremendous low-cost loan programs available through the Federal Government to build dormitories, build libraries, and do other infrastructure development on college campuses.

All of those programs have disappeared. We are left with the by-products of those programs, which are buildings which are now deteriorating. In order to replace them, we need to go out to the private markets.

For private colleges and universities, particularly those in States that do not have such programs, the only thing left to do is to go out and borrow the money commercially, and that is where the credit rating game comes in.

The other piece of this, I should just mention very quickly, is the quality of buildings, grounds, facilities, and technology directly relates to the arms race for students. Student consumers demand, today, the most extraordinary amenities.

When you and I went to college, we might in fact have been satisfied to share a room with three plugs. The fact of the matter is today, the average college student comes with appliances that require 20 or 30 three-prong outlets in many rooms. This is true.

Students today at Trinity just marvel at the single-pipe steam heat system that starts clanging when we turn the heat on. They have never heard of a single-pipe steam heat system before. I need $100 million to renovate the buildings on my campus. But believe me, with the 40-percent discount and serving the students we serve, we are not going to have that kind of money any time soon. This is part of the problem that we face in higher education, the haves and the have nots.

Senator BUNNING. Thank you very much.

Maybe we should go back and take a look at what our former colleague did in Georgia, Senator Zell Miller. Anyone in Georgia that desires a higher education can go to the University of Georgia and be charged no tuition—no tuition—if you are from Georgia.

If you are an out-of-State student—and they only accept 20 percent out-of-State students, of which my granddaughter happens to be one—the cost for the out-of-State students is extremely high. But all the other programs that we have presently on the books are trying to lessen the burden for people to get to college.

They may be disproportionately geared, according to some of you, for the more affluent students, but that was not the intention. That is the way they are being used presently. We can correct that by legislation. We can correct it by moving credits and exemptions, as suggested, to a simplification.

But the whole point is, not all students want to go to college after high school. We have to have some type of school system that will take care of that student also. There ought to be some available funds for that student.

I am talking about vocational schools, vocational education, and training of other types of students rather than our good students

that go on to get very good educations at the University of Kentucky or the University of Missouri, or wherever.

I think it is very important that we look at the whole spectrum of students who use the ability that we have in place right now. We do need to improve it, there is no question in my mind. Thank you.

The CHAIRMAN. Thank you.

Now, Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

I just want to thank both Chairman Grassley and Senator Baucus for really drawing together this very important discussion today. I think it has tremendous impact on the future of our country and, without a doubt, a tremendous impact on the future for our children. Promoting post-secondary education is such an essential element of any effort in preparing our workforce. We all know that.

We know that if they are going to meet the demands of today's increasingly competitive global marketplace or the demands of tomorrow, we have to give them the kind of education that is going to be substantive enough that they can be competitive in that global marketplace.

But I think it is also important for us to recognize that it is a huge part of our economy. The statistics show us that college graduates and what they will earn in their income over a lifetime versus those who do not get a college education is phenomenal, and what that means to our economy.

So, we are delighted you are here. We hope that you will remain with us in this discussion. But I hope, for our benefit as legislators and stewards of our government here, that we will begin to direct ourselves to look at this issue and this discussion as an investment and not a give-away.

Way too often we look at these types of programs as give-aways, and then we have this big brouhaha about who is deserving and who is not. If we look at education—higher education particularly—as an investment, then I think we will have a much more productive discussion and a much greater outcome.

So I encourage my colleagues, as we move forward on this discussion, that we will actually do that. I look forward to being an enormous part of that.

I just wanted to mention a couple of things. I know I keep shaking my head when Ms. McGuire speaks because I went to a very small liberal arts private college. It was an all-women's college. I read my bulletin and I see that over 80 percent of the student body is on financial aid.

Being able to provide the kind of diversity that a small college provides was incredibly important to me. The diversity was incredibly important to the college, being able to admit a large number of international students, low-income students. Being able to create a diversity on campus that, itself, was a laboratory for learning was very important, and it was important to me.

So I do think that there is definitely a wide span as well in terms of our institutions of higher learning, and a lot of the challenges they face, particularly since it did come from two centuries ago, my

campus did. I remember as the heat got kicked on and the radiators started to bang, it became a very positive memory in time.

But just a couple of questions. One, Mr. Brostek, you mentioned the lack of research that currently exists regarding the effectiveness of both title IV programs and our education tax incentives.

I would say to Dr. Dynarski, we have been working for 4 or 5 years to make the child tax credit refundable. Making tax credits refundable is not an easy step. It is difficult to convince people that, again, this is an investment. It is not a give-away to somebody who is still working hard, still trying to save, still trying to reach the American dream like everybody else. So as we do that, I hope we keep in mind what we are capable of here and how hard those kinds of steps are.

But when we talk about the research, before we make fundamental steps to rewrite education incentives in either area, whether it is title IV or the tax code, it would make sense that we would want to look to make sure policy makers can come together and sort out what is working and what is not.

So I guess, obviously this hearing is a huge step in the correct direction for that, but how feasible do we think it is for us to get relevant agencies moving on this type of research, and do we have the capabilities—or do they, I guess—if they are provided the kind of resources they need to let us know what is working and what is not?

Mr. BROSTEK. The Department of Education has taken a step by establishing a research institute. This past year they put out a Request for Proposals for research, and I believed they received them in the November time frame. I am not sure what will be funded yet, but there is an effort there to start looking at the provisions.

One of the problems that we have noted in the past and in our prior work is that, for the tax provisions, they are often sort of an orphan without a home in terms of being studied for their effectiveness.

Senator BAUCUS. Say again?

Mr. BROSTEK. The tax provisions are sort of an orphan when it comes to someone taking responsibility for determining whether they are effective. The IRS is interested in ensuring that we are all paying the correct amount of tax, and they do not see it as their mission to determine whether a particular provision is accomplishing what Congress intended.

The Department of Education, in this case, does not have access to taxpayer data under the privacy provisions of the law, so their ability to do research is somewhat constrained for that reason.

That leaves the Department of the Treasury as perhaps the more likely Federal agency to do this kind of research. They have a relatively small staff. The last time I recall, there were over 163 special tax preferences in the Code, and there is very little research that Treasury does on that wide array of tax provisions. So, we believe it would be useful for Treasury, Education, and the Office of Management and Budget, who is responsible for resources——

Senator BAUCUS. Joint Tax would be in on that, too.

Mr. BROSTEK. That is true. The JCT. We do some research for you on these provisions as well. But within the executive branch, we think those three agencies need to work together on a strategy

for figuring out how we are going to analyze these provisions on what kind of schedule, and who is going to be responsible.

Senator LINCOLN. Well, that makes sense. As Dr. Dynarski mentioned, it is kind of a no-brainer to know that if you are at a lower income, the tax credits are not going to be as useful to you.

But we do need to know better, I think, in terms of what works, what does not that we have, and then go back in and look at how we restructure the unified credit. Going to those types of ideas could be very useful with the programs.

But the other thing is, some of these programs are so complicated that having the student apply for them, things like the Perkins loans, which are enormously helpful to the institution taking the resources and then sending them out, we have cut Perkins, unfortunately, way too much, in my opinion, and many institutions have suffered, and so have the students.

Dr. LONG. If I may, I think you are exactly right. I am glad to see this discussion about simplification. We actually do know quite a bit about the effect of financial aid, and I am happy, as an academic, to have a chance to present some of these findings, some of the work that I have done, as well as Dr. Dynarski, and our colleagues.

We have seen that financial aid can work, but it does have to be simple. There has to be clear information. Policies such as the Georgia HOPE scholarship—one of the reasons why it was so effective in increasing enrollment and affecting choice is because it was very simple to understand.

High school guidance counselors were trained in telling students about it. Even third graders can tell you, if I do these things, get a B average in high school, I know that I can get free college tuition in Georgia.

As we are thinking about different policy options and what can we do in terms of the tax side, I would like to reemphasize something Dr. Dynarski brought up earlier, and that is the fact that the IRS has lots of information about families in the United States. They know which families are low-income. They know the age of their dependents.

If information is such a problem, can we use the information that the IRS has to inform families, similar to the way that we do in terms of Social Security, that you have a child of a certain age who might be thinking about going to college? There are these benefits available to you. Plan ahead. Take the academic courses necessary for you to be able to go to college and succeed in college, because this money is there.

So we do need to think of ways that we can streamline our government policies and use the information that we have to try to improve outcomes for families. I say you are absolutely right.

We know that education is vitally important, and we know that there are huge returns to going to college, not only investment, but if we also think about the counter-factual: yes, we know investing at an early age is very important, but think about that 18-year-old. If they do not go to college, they have 60 years in our society without skills, and we know that that is very, very costly.

Senator BAUCUS. Senator Schumer? Your time has expired.

Senator LINCOLN. I just wanted to say, if the seventh-grader does not take algebra, by the time they are 18, it is really tough. So we need to start earlier, working with the kids to see what they have.

Senator BAUCUS. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Senator BAUCUS. No, no. No, no. [Laughter.]

Senator SCHUMER. Not yet. Mr. Ranking-Member-soon-to-be-Chairman. I want to thank you and Senator Grassley, our present Chairman, for calling this hearing, because we all know about the rising cost of tuition. It is one of the issues that American families struggle with every single day.

I think when parents go to bed at night, this is one of the things that keeps them up, how are we going to pay the kids' tuition, more than just about anything else. It is undeniable that sustaining a talented, college-educated workforce is essential to our success in the global economy.

The great irony is, a college education has become a necessity in the challenging world young people face, yet it is priced like a luxury. Over the past 2 decades, the growth in the price tag of a college education has outpaced inflation, I think, for the last 26 years. Skyrocketing tuition means hard choices about the family budget.

Every time a young American does not go to college, even though they deserve to, because they cannot afford it, or they do not go to the college they should because they cannot afford it, they lose, their family loses, and America loses.

I want to address two points in that regard. The first is the provision on college tuition deduction, the above-the-line deduction. I was one of the authors of that. Senator Snowe and I had been pushing that. It passed in 2001.

It allowed up to $4,000 in tuition expenses for families whose income was below $130,000, $2,000 for a family whose income was up to $160,000, for a couple. I was terribly disappointed that the House and Senate leadership allowed this provision to lapse this year.

Here in the Senate, as Senator Grassley mentioned, in a bipartisan way, we passed it with 66 votes, a 4-year extension. Yet, in what was clearly a case of misplaced priorities, the conference committee eliminated it and chose to restore some massive breaks for oil companies instead.

My friend, Mr. Chairman, mentioned that this became an issue in the campaigns. Damn straight. It should have. This Congress should not have allowed that tuition deductibility to lapse, particularly to increase tax breaks for oil companies.

So I hope we can amend that now. I want to praise the Chairman and Ranking Member, because I know you are both working hard to get this done in the wee hours of the 109th Congress. I am hopeful this 2-year extension, which really has to be retroactive to January of this year or middle-class families will not get it, will come to pass.

Now, I want to make one more point. That is, in the area of college tuition, that is one of the areas, if we are concerned about complexity for middle-income taxpayers, Congress could make some sensible changes. This is just in tax simplicity. It is a little dif-

ferent than the good point that Dr. Long was making, but I think it is an important point.

I want to take a moment to talk about a bill I will be introducing in the next Congress, which I hope will receive bipartisan support. It is a bill that reflects today's topic, but will represent a significant simplification for millions of taxpayers.

The way I look at it, we often hear about tax simplification, but most of the time that is just code for eliminating certain taxes on investment or business income.

If you leave out the Alternative Minimum Tax, which is another issue I hope we can address in the next year, the tax code is not really that complicated for average middle-class families that earn most of their income from wages and take the standard deduction. That is about two-thirds of the public.

There are a few areas where the tax code would be simplified that would make a real difference for the middle class, and one of these is to combine the various higher education tax incentives.

Assuming the tuition deduction is extended—that is separate—we will have three main tax breaks for higher education: the HOPE credit, the Lifetime Learning credit, and the tuition deduction. Ten million taxpayers receive one of these benefits each year.

The intent of Congress in enacting these three benefits was essentially the same, an attempt to make college more affordable for middle-class families by providing them with a modest tax benefit. But the taxpayer has to pick just one because claiming one of these credits is a disqualification from being eligible for the others.

Under each of these programs, the benefit families receive depends on their particular tax and income situation, as well as their tuition expenses. It is not immediately clear which program helps a family the most because the rules and the dollars are different and complicated.

So what do taxpayers do? They sit down with one of those legendary IRS worksheets and calculate them all in order to determine the best one that could help. Is it any wonder that Americans find this part of the tax code confusing and frustrating?

So I am going to introduce legislation that takes steps towards making the tax code a little less complicated for the middle class struggling to send their kids to college.

I am going to introduce a bill that will consolidate the HOPE and Lifetime Learning credits, and the above-the-line deduction into one single streamlined, easy-to-understand credit. It is a simplification proposal recommended by the nonpartisan Joint Committee on Taxation.

I am not going to go into the details of what they have recommended. I would ask, Mr. Chairman, that my entire statement would be read into the record.

[The prepared statement of Senator Schumer appears in the appendix.]

Senator SCHUMER. But I see my time is expiring, so I would just ask any of you to comment on that type of simplification.

Ms. MCGUIRE. I think simplification is welcome. As Dr. Dynarski explained earlier, anything we can do to make it easier for the consumer to have access to these benefits is important.

I do wish to follow up with just one comment. There is a lot of research, and many studies have been done, on tuition. The reality is, families are willing to pay extraordinary tuition at very few institutions in the country.

Part of the headlines that are generated every year when the tuition reports come out, once again, are about a very few elite institutions, where even middle-class families will pay, as Dan Golden's book underscores, just about anything to get into a few certain institutions. There are plenty of affordable options for every family in this country.

I should note that there are more than 17 million students this year in higher education, the highest number ever. The fastest-growing group in higher education is low-income black and Hispanic students.

There are hundreds and hundreds and hundreds of private universities and colleges that are extraordinarily affordable. As I said in my testimony, at Trinity, the average out-of-pocket expense is about $2,000. Our discounting practices are such that we are providing significantly more aid through our own institutions than all of the Federal aid combined.

So at another hearing, perhaps at some point, we can go through the tuition price issue and the discounting issues in more detail, because the headlines do not really represent the actual costs to consumers.

Senator SCHUMER. Tuition did go up higher than the rate of inflation for the last 26 years. Is that correct?

Ms. MCGUIRE. Yes. And there are reasons for that. One of the reasons is discounting by institutions. In fact, the return on financial aid to students is driving up the cost of tuition. It is a paradox.

Number two, what I referred to earlier, the cost of facilities and technology far outstrips the rate of inflation on just about all of our campuses. Third, risk management. The cost of insurance, not only health care, but property, casualty, and liability insurance, is skyrocketing.

Fourth, the cost of our labor pools is increasing, in many cases, faster than tuition, in part because we are having to add lines because the students and the families do expect significantly more services today than ever before. The amount of service expectation that colleges and universities are expected to provide today, as well as the quality of the infrastructure, is helping to drive these costs up.

I can certainly present charts and graphs, and I do every year to my own students, on where every single dollar goes. Frankly, I know very few presidents who cannot justify where every single dollar goes.

Senator BAUCUS. Mr. Golden, I have a question for you. Namely, do we do anything about all these categories of privilege that you are talking about, or otherwise just let the colleges do their thing, whether it is Harvard, Yale, Stanford, or whatnot, that tend to accept the most wealthy, the sons and daughters of administrative personnel, and the other categories that you mentioned? Is there a role for Congress to do anything about that or should we just let it be?

Mr. GOLDEN. Well, I do make a few recommendations in my book; whether they would be done by Congress or by the colleges themselves is sort of beyond my role as a journalist to say.

But what would be beneficial to see happen would be to eliminate some of these preferences, such as the preference for children of alumni, as members of this body, such as former Senator Robert Dole, have advocated; John Edwards spoke to it in his presidential campaign, preferences for alumni children, because that is a predominantly affluent community.

Senator BAUCUS. You say eliminate, but that would be voluntary.

Mr. GOLDEN. Yes. Well, as a journalist, the *Journal* is not too comfortable with me making specific legislative proposals.

Senator BAUCUS. I was surprised to see you here, actually.

Mr. GOLDEN. Yes. So, I have to tread carefully there. I would note that a couple of years ago, as I describe in my book, Senator Kennedy made a number of proposals along these lines on legacy preference, including sunshine legislation that would have at least required colleges to make clear how many students qualified for it or benefit from it. I go into that in detail in my book in a relatively sympathetic manner.

Senator BAUCUS. Dr. Duderstadt?

Dr. DUDERSTADT. Yes. I just wanted to comment on tuition for just a moment, because 75 percent of the college students in this country attend public institutions.

Senator BAUCUS. Sure.

Dr. DUDERSTADT. In public institutions, tuition represents, on the average, about one-third of the actual instructional cost. The reason for that is the discounting provided by a State subsidy through appropriation.

Today, State support of public higher education on a per student basis is at an all-time low for the last 25 years. As enrollments have increased, costs have increased. The States, with populations that have other priorities—health care, retirement, safety from crime and low taxes—have shifted away from it. It is a serious issue.

What you are seeing is the plummeting of the State as a partner in public institutions. At most of the flagship public universities now, the research universities, State support is now less than 20 percent. At my institution, it has dropped to less than 7 percent of our operating budget. So there is really no slack in the system.

Tuition has to compensate to some degree for the loss of State support, and yet, nevertheless, it still remains only a small fraction of the actual instructional costs at these institutions.

Senator BAUCUS. I am just curious. Join in any time you want here. We have not talked a lot about the role of corporate aid in education very much. State appropriations, tuition, public financial assistance. But what about business? What is the role of American corporations toward contributing more dollars to education? Ms. McGuire?

Ms. MCGUIRE. Well, Senator Baucus, unfortunately it may reinforce the stereotype of the elite institutions, in fact, wicking up most of the dollars. But it is true that a very small number of research universities receive about 75 percent of all charitable gifts

to American higher education, and the substantially large gifts in that pool are corporate gifts.

It is very hard for the very small institutions to receive very significant corporate gifts. Sure, we get matching gifts and occasionally we receive very, very nice grants.

It is more likely today, in fact, certainly here in the District of Columbia and the Washington region, that corporate support is going massively into K–12 education, and I have a hard time arguing with that because K–12 education is in such great need.

There also are opportunities for colleges and universities to partner with corporate supporters on very specifically targeted programs, such as nursing, health professions, and that sort of thing in areas of great workforce need. But the reality is, the largest parts of corporate support are heading toward R&D and the research universities.

Dr. DUDERSTADT. Well, let me respond to that as well. Roughly a third of the Spellings Commission consisted of people from industry and from business, and they pointed out, they spend massive amounts of money on workplace training.

Senator BAUCUS. That is right.

Dr. DUDERSTADT. Taking college students as they graduate and then providing further skills.

Senator BAUCUS. Right.

Dr. DUDERSTADT. If, in fact, the colleges and universities could better align themselves to provide some of those skills, those in business and industry might be quite willing to redirect those resources into higher education. But, of course, colleges and universities have a certain autonomy.

While we regard business and industry as the marketplace, the recipient of our graduates, there is a lot of resistance, and understandably so, for having them dictate the nature of our curriculum and our pedagogy. So, there is an uneasy tension. I think the key here is forming much more sophisticated partnerships between the business community and higher education which meet the needs of both institutions.

Ms. MCGUIRE. If I may just footnote very, very quickly. Let us not forget that 72 percent of the students in higher education are non-traditional students, many of whom also were funded by their employers through employer vouchers. We always tend to leave them out of these discussions.

Senator BAUCUS. Say that again. What is that figure again?

Ms. MCGUIRE. Seventy-two percent of all undergraduate students in higher education today are non-traditional, either by age or independent status and so forth, and a significant number of those are working students who are funded by their employers, and that is another whole discussion of the tuition situation.

Senator BUNNING. May I ask Dr. Dynarski a question?

Senator BAUCUS. Sure.

Senator BUNNING. I have been active in 529 plans, especially in the House of Representatives when I was there, to include room and board cost as qualified higher education expenses under these plans. I would like your comments on the types of expenses that qualify under the various plans, credits, and deductions.

For instance, I understand that the cost of books is not a qualified expense for the purpose of the above-the-line deduction, but can qualify as a qualified expense for other educational provisions in the tax code.

In particular, do the current allowable expenses appear to be adequate? Are there other expenses that should be identified as allowable education expenses? Are you aware of proposals made by the administration to streamline the various definitions of a qualified educational expense, and can you comment on these proposals?

Dr. DYNARSKI. This feels like my general exams in graduate school. [Laughter.]

Senator BUNNING. Well, that is why you are here.

Dr. DYNARSKI. I can say that one great part of the complexity in the tax provisions is that they each define qualified expenditures differently, so the 529 definition, as far as my current understanding—it changes constantly—is the most generous.

So under the 529 provision, you can count room and board and tuition and fees as qualified expenses. Books. I think computers as well. It is pretty generous.

For the above-the-line deduction and for the Hope and Lifetime Learning credit, it is much more limited. You are pretty much limited to tuition and fees. As I said, a big chunk of our expenses when we go to school are not the tuition and fees, it is the other costs. It is the living, it is eating, it is paying your rent, it is buying your books.

We have a system in which the people who can afford to save for college through the 529s can list those as tax-advantaged qualified expenses, but people who are instead perhaps taking advantage of one of the credits cannot. So, that is inconsistent.

Senator BUNNING. That would be one of the areas that you would merge.

Dr. DYNARSKI. I want to make it consistent.

Senator BUNNING. Consistent.

Dr. DYNARSKI. Yes. And I think it would have a progressive impact if it were to be made consistent in such a way that it brought in more expenses for people who go to low-tuition institutions like community colleges, which would mean bringing in room and board.

Senator BUNNING. All right. Thank you, Mr. Chairman.

Senator BAUCUS. Yes. Thank you, Senator.

We all see a lot of parents, families, who eagerly page through *U.S. News & World Report,* the top 10 graduate schools, all the top 10. Is there not another role for *U.S. News?* [Laughter.]

Dr. DYNARSKI. Yes.

Senator BAUCUS. And what would that be? Of course, they have to market their magazine and get their ad rates up.

Dr. DUDERSTADT. Perhaps they ought to pay more attention to you folks.

Senator BAUCUS. Yes. And, of course, they have a certain market they are catering to. But it seems to me that they could perform a public purpose here, a public policy purpose here of some kind, maybe using other criteria, too, just to help advance the ball here and help middle-income and lower-income students get education.

Ms. MCGUIRE. I am so happy you raised that, Senator Baucus. It is one of my other favorite topics. I actually just wrote an article on this topic. The reality is, *U.S. News & World Report* favors wealth, and most of its criteria, in fact, are about money.

If you look at the institutions who are down in the lower tiers of that magazine, you will find an extraordinary number of smaller institutions, like Trinity, like many others, women's colleges, Catholic colleges, State institutions that are serving remarkably diverse, remarkably low-income populations, working effectively with their cities and towns, with their corporate communities doing exactly the kinds of things that members of Congress and Senators are expressing they value.

I would certainly dearly love to see some ranking system that honored the institutions who serve a large proportion of low-income minority students and who, in fact, have turned around many, many students and their families from thinking they could not complete college to, in fact, being successful, not only baccalaureate students, but graduate students. We have many at Trinity, and there are many other institutions that do that.

Senator BAUCUS. Dr. Duderstadt?

Dr. DUDERSTADT. Ranking is kind of a sensitive issue to the University of Michigan today. [Laughter.] I had the opportunity to meet with the editor of *U.S. News & World Report,* along with the presidents of Stanford and Columbia, and we laid out our concerns. It was a new editor. He said, look, I agree with you completely, but I am told by others that it is a very important source of income for us, and it is unlikely to change.

Senator BAUCUS. Yes, it is.

Dr. DUDERSTADT. I think that is one of the reasons why one of the key points in the recommendations of the Spellings Commission was this stress on this accountability, transparency, and public purpose to get more information out to students and their parents about learning outcomes, about how costs are really determined, what the real prices are, and what the values are of their education.

If that could be done through other sources, perhaps the Department of Education or others, it would be a counterbalance to essentially a commercially driven activity of *U.S. News & World Report,* and I think would be very much in the interest of American higher education.

Senator BAUCUS. Are there certain data that we do not have or that are not reported?

Dr. DUDERSTADT. The most important data that you can gain, which are not collected or reported, are based on learning outcomes. Again, back to the Spellings Commission, one of our challenges was to the faculties and to institutions to clearly define the educational objectives of their programs and then provide to the public evidence of how well their students are achieving that objective.

There have been experiments along that line. The State of Texas has been very out-in-front on it. But it is something that really has to be embraced more by higher education, by the accreditation agencies and the institutions, to measure outcomes rather than simply inputs, and to report those outcomes to the public.

Senator BUNNING. I would like to ask this panel, because I think one of the big things that we lack is the K–12 informing our students about what a college education means, what a college education means later when they go to work, and the differentials that it means. That is not done in most high schools that I know of.

It is so essential for those students who eventually go to college to understand the difference. What is going to happen to me if I do not go to college, and what is going to happen to me if I do go to college?

If that is explained in toto to our students in high school, and what is necessary in high school to accomplish that goal, then I think our K–12 system, whether it be private or public, would serve a much better purpose than it is doing now because that is not done. The parents are the ones who are really concerned because they understand the difference, usually, even if they are not college graduates as parents.

But if they are college graduates as parents, they really understand what is the difference if you do not, or you do, go to college, whether it is Trinity, whether it is the University of Michigan, or Harvard, or wherever it might be.

Dr. LONG. Absolutely. I think you are highlighting that there are several pieces of information that are missing. First, preparation. Students do not know what they need to do in high school in order to succeed in college. We give them high school requirements that do not match the requirements of what they need to meet in terms of college-level work.

We have discussions about K–12 academic reform. Very few people from higher education are part of those conversations to say, this is what students need to do in high school in order to succeed in college so that there is academic preparation.

The second piece is affordability issues. As we have talked about, we have this list tuition price which really does not capture what students are paying, what types of financial aid are available, how that financial aid is being awarded, not just from the government, but from the institutions.

To go back to the *U.S. News & World Report* situation, that is a survey all about inputs, the students that are coming, what their characteristics are before they even get to the college.

We know very little about what actually is happening in colleges while the students are there, what kinds of supports they can expect, what types of things they will learn, as well as learning outcomes. What is the output of these schools? So, there are lots of pieces of information that we are missing right now.

Now, there are certainly efforts to try to increase this information. I know the Department of Education has tried to create a website with more of these types of pieces of information, but part of the problem is, families do not know that that information is there. Everyone knows about *U.S. News & World Report.* Those issues come flying off.

Senator BUNNING. I can just give you an example. In the Commonwealth of Kentucky, K–12 in the public educational system is 70-some percent paid for by the State. Now, that should be an informational tool that is used in that 70 percent pay, that all those

things that you are talking about are brought forth to that student that is going through the process.

If it does not happen, that poor student is going to wind up in the ninth, tenth, eleventh, and twelfth grade knowing, sure, I want to go to college, but I am sure not prepared. Only in certain very sophisticated high schools is that information being given out.

Ms. MCGUIRE. Senator Bunning, just if I may, two quick comments. One is, the Gates Foundation is conducting a lot of studies right now around the country, in urban public school systems in particular, to address some of these issues.

Second, 2 weeks ago in the Sunday *New York Times* magazine, there was an excellent article called "What It Takes To Make a Student," which is referenced in my testimony in a footnote. I highly commend it to you and to other members of this panel interested in these issues, because it really unpacks some of them.

Finally, here in the District of Columbia, as a result of the initiative that Congress took to create the DC Tuition Assistance Grant program, we really have a model that, in fact, addresses some of these also through the combination of the Federal funding in that program and the private funding that was made available.

We have a college access program now that puts counselors in high schools to address these very issues. I think it is a national model well worth looking at.

Senator BUNNING. Thank you.

Dr. DUDERSTADT. I was going to say, it was one of the conclusions, and one of the most important ones of the Spellings Commission, that higher education itself must become much more deeply engaged with primary and secondary education. There are some excellent models of that around the country.

We pointed out the California State University system, which goes into every high school in the State of California with faculty and with programs, providing in person exactly what is required for transition into college work.

Senator BUNNING. Mr. Golden?

Mr. GOLDEN. In the area I researched of admissions preferences for the wealthy, in terms of how much Americans know about what they are facing, I found colleges were often less than candid about the extent of these preferences that they would provide. They would typically argue that there is no influence or intervention of fundraising on admissions, whereas, I documented that there was.

They would generally understate the impact of preferences for children of alumni so that the average applicant from an unconnected middle-income family to a selective school would not realize that their chances of getting in were actually much lower than they thought they were. If the overall odds were 1 in 5, 1 in 8, or 1 in 10, that meant that their chances were 1 in 10, 1 in 20, or 1 in 30.

Senator BUNNING. Thank you very much.

Senator BAUCUS. Mr. Chairman, before I have to leave here, I would, with your permission, just request to all six of you, to the degree you are interested, do a little analysis of the so-called Dynarski suggestion and modify it, tweak it, refine it, whatever. Simplicity. Combining the Pell and refundable credits, and get the money up front, get it early, as near as I can understand it.

Dr. DYNARSKI. I do have a longer paper that goes into detail. If you would like to read that, I will make it available to staff.

Senator BAUCUS. I would appreciate it if you could look at that from the point of view of simplicity, how well it can be administered, the degree to which IRS really can do this, and whatnot.

The goal here is to be practical and pragmatic and make something work here. I do not care about committee jurisdiction. It does not make any difference. Just, what works? That is the main thing here.

If you could, maybe separately, just give this committee, in written testimony or just written remarks somehow, at your leisure, just what you think about it, we would appreciate it.

Dr. DUDERSTADT. Very good.

Ms. MCGUIRE. Happy to do so.

Senator BAUCUS. Thank you.

The CHAIRMAN. By the way, we will not keep you very long. I just have four questions. Hopefully they will not take very long. I know the first one will not.

Dr. Long, you made a statement this morning—and I do not question your statement this morning—about not being able to show a relationship between government programs and inflation of tuition.

But I want to know about the interplay between that and your work in the Georgia HOPE program where you found "the results suggest that 4-year colleges in Georgia, particularly private institutions, did respond by increasing student charges. In the most extreme case, colleges recouped approximately 30 percent of the scholarship award."

Dr. LONG. Sure. I can definitely speak to that study. So obviously a number of researchers have been trying to see if colleges are responding to financial aid. Now, the Georgia HOPE scholarship is a very special case, and it does not apply at all to what we have in the Federal context.

The CHAIRMAN. All right. Then that is enough if it does not apply. All right.

Now to Dr. Duderstadt. As the president of the University of Michigan, you were very active in issues regarding the NCAA. This is not the direct focus of this hearing, but the tax-exempt status of that organization has been the subject of a great deal of scrutiny by the Ways and Means Committee of the House, and is certainly relevant to our work here.

I would appreciate your views on whether the NCAA's response to Chairman Thomas was adequate, and if not, what other additional questions or information should Congress receive to better consider these matters? In addition, I would appreciate any additional points that you would have on that matter.

Dr. DUDERSTADT. Sure. There has been a growing concern on the part of a great many people, both within higher education and beyond, that the increasing commercialization of the big-time programs—college football, men's basketball—are beginning to distort the academy, to some degree.

You see it in the sense that the increase in costs of intercollegiate athletics has been increasing at three times the rate of academic costs over the course of the last decade.

Part of that may be due to some of the perversity of the tax code, for example, treating quid pro quo transactions such as the leasing of luxury sky boxes or the ability to purchase season tickets as charitable contributions, which of course they are not.

But it also relates to the broader array of commercial activities engaged in by the NCAA and by the institutions. That was, I think, very effectively challenged in the letter from Congressman Thomas in the House Ways and Means Committee to the NCAA.

I think the NCAA gave great care to its response, much of which was useful and informative, but it was, in part, a mixed bag. To some degree, concerns were passed along to the institutions saying that the NCAA really did not have influence over that. You could raise the question of, should they?

Some of it was hidden behind the broader intercollegiate athletics enterprise, the vast array of sports which do not suffer from the drawbacks of the commercialization of the big-time football and basketball programs. And, of course, some of it simply was information the NCAA did not have.

I think it is always important that, from time to time, a shot across the bow is aimed at the leaders of intercollegiate athletics to force them to step back and really think deeply about whether their decisions are being made in the best interests of the educational opportunities provided the student athletes involved in their programs and in the best interests of their academic institutions.

That is what that letter did. I think it will lead to further debate and concern, and hopefully persuade the NCAA and the institutions themselves that maybe they should take some steps to reconnect intercollegiate athletics with the academic objectives of their institutions. Perhaps cleaning up some of the tax policy, perhaps further consideration of such changes, is the stimulus that will cause them to do that.

The CHAIRMAN. Professor Long, your testimony talks about getting more information from colleges focusing on net tuition prices. This matter of getting more detailed information and a sense of greater transparency and accountability from the colleges is something that is discussed quite a bit.

I would ask you, but also maybe panelists who want to comment on it, for thoughts on what improvements in transparency, accountability and reporting should we look for from colleges and universities. I know, for instance, Professor Duderstadt, that the National Commission on the Future of Higher Education talked quite a bit about improved openness. As charities, these entities are required to file 990s, available to the public.

As we heard in our hearing on hospitals, the Form 990 is very inadequate in providing useful information regarding hospitals, and that needs to be upgraded. I am interested in what we should do in terms of information at universities.

Dr. LONG. Absolutely. As we said before, list price really does not capture what students are paying. There are many decisions that colleges are making that affect student affordability and access. We need to know a lot more about what types of institutional aid they are giving, not only the averages, but exactly how they are awarding this aid, and to whom.

Some of this aid is being used for needy students, particularly at the top institutions that are holding true to their mission, but an increasing proportion of this is going for merit-based aid—high-achieving students where we definitely want to recognize their achievement—but it is going to students who do not need the money as much as others.

So, having more information on exactly how colleges are using their money to either help affordability or serve other goals would help us to understand a bit better what the next steps should be. I think certainly transparency would help a great deal in pushing colleges to do more honorable things, and some certainly already are.

The CHAIRMAN. Ms. McGuire?

Ms. MCGUIRE. Senator Grassley, I always take the peculiar attitude, well, since my salary gets published anyway, nothing else is secret. I am, perhaps, a renegade among college presidents in that I think our accreditation reports should be open.

We already have all the data that everybody is looking for, whether it is the Spellings Commission, or this committee, or Congress. It resides in these massive reports we prepare for all of the many accrediting agencies to which we are accountable. Most of it is not secret.

Sometimes it shows some institutional warts and deficiencies. In fact, I think by being more candid about where we struggle, where we need help, we would have a lot more credibility.

So, I have been calling on my colleagues to think about how a little humility in sharing information, not just the glossies but in fact some of the realities, would actually help us as an industry. It is all there.

The CHAIRMAN. All right. So you are agreeing with Dr. Long, there needs to be more transparency?

Ms. MCGUIRE. Yes.

The CHAIRMAN. All right. But you are also saying it is not a lot of extra gathering of information, it is just making it more public than what they do in their report, and probably in a more understandable way.

Ms. MCGUIRE. I think most of the information already exists. At Trinity, we put our self-study, as well as the team report, on our website. We see nothing to hide. It is not all 100-percent glowing, but it is real. We think cinema verité would serve us all better in this environment.

The CHAIRMAN. All right.

Mr. Golden, your book talks about how the wealthy are able to load the dice in favor of their children being accepted at these top colleges. I was particularly taken by the situation you write about of the committee on university resources at Harvard.

It seems that there are some individuals who are not alumni who are giving large donations with an eye towards significantly increasing the chances of their child being admitted. Would you provide the committee with more detail on how that operated?

Mr. Golden. Yes. At Harvard specifically, the committee you mention, of its 400 or 425 biggest donors, those are primarily alumni, but they also do include some non-alumni. By virtue of being on that committee, and through other ties, they generally have ac-

cess to Harvard officials or admissions people and are in a position to put forward the cases of their children.

More generally, while colleges say that they maintain a separation between fundraising and admissions, in reality, that is quite rare. At most colleges, the fundraising office usually provides a list of applicants to the admissions office who, if they are admitted, the parents would donate a lot of money.

Sometimes there is also a list from the alumni office and the president's office as well. So the goal for wealthy people, like the people on Harvard's committee or other people of means, is to get their children's names on these lists and get their applications flagged for special attention. Sometimes they do that through contacts with trustees or other officials.

Sometimes they might hire an independent counselor, who then would possibly contact the development office at the college and say, the family that I represent is in a position to donate if the child is accepted.

So they make known their philanthropic interests to the college they would like to send their child to, and thereby the child gets on a list or gets a preferred status in admissions.

Then there comes a meeting between the admissions people and the fundraising people, where they sort of debate, often, can we let this candidate in even though their credentials are not of the best? How far should we stoop? How much money is likely to be given? How big is the institutional interest in this family? Decisions are hammered out in those kind of meetings.

The CHAIRMAN. I think this is an example of our questioning whether the tax incentives are working in the way that they should, as in this case that you bring up, whether individuals who made donations to this organization, or any organization—in this case, Harvard—should be allowed to take a charitable deduction if they did not appear to have a charitable intent, but instead gave money for the purposes of a personal benefit, namely to get their children accepted.

This is something I think I would ask the IRS to review, or at least ask them for their views on this issue, and understand what actions have to be taken in this area.

In closing, I think we had a very useful discussion today. There seemed to be strong member interest in simplification and controlling costs. Clearly, those are areas we ought to look at next year. I think ensuring greater access at our elite colleges is also something that we need to consider closely at some time in the future.

Thank you all very much for your testimony.

[Whereupon, at 12:15 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Opening Statement of U.S. Senator Max Baucus (D-Mont.)
"Report Card on Tax Exemptions and Incentives for Higher Education:
Pass, Fail, or Need Improvement?"
Hearing before the Senate Finance Committee

Thank you, Mr. Chairman, for calling this hearing.

Aristotle wrote: "The legislator should direct his attention above all to the education of youth."

That was true in the cradle of democracy 2,300 years ago. And it is just as true of our American democracy in our increasingly competitive world.

According to the recent Competitiveness Index, the United States is in sixth place. We are behind the Nordic countries and Singapore.

To compete in the global economy, we need to make education our top priority. We need to improve access to higher education for all Americans.

And so today we will talk about access to education. We will talk about the rising cost of college tuition. And we will talk about what we can do to make college more affordable for students and families.

I have spent the past year and a half advancing a comprehensive competitiveness agenda. Education is the foundation of our future competitiveness.

That is why I introduced the Education Competitiveness Act of 2006 in September. My bill encourages excellence, welcomes innovation, and promotes access.

In addition to addressing access to college education, my bill promotes teaching by providing 100 thousand scholarships for future teachers of languages, early education, and science. My bill will also get every child ready to learn, with nationwide, voluntary pre-kindergarten.

--more—

We must also improve tax incentives. And we should make sure that grant aid that can give greater access to education for all Americans.

The current tax incentives available for higher education are confusing. My bill simplifies the credits and helps families save for higher education.

College tuition is up six percent from last year. America's working families are struggling to provide those extra dollars for college. In my state of Montana, where the median family income is one of the lowest in the country, we need to do everything we can to make going to college more affordable.

We must give every student a chance at college. Two-thirds of full-time students receive grant aid. And in Montana, that figure is closer to 80 percent.

Pell Grants don't go as far these days, with tuition so high. And the Pell Grant hasn't been increased in three years.

That's why my Education Competitiveness Act raises the Pell Grant to $6,000. That way more students can access the benefits of a higher education.

I constantly hear from Montanans about the rising costs of tuition and how much harder it is now to fund a college education without going into tremendous debt. We need to be listening to the folks back at home who are hit hardest by the high cost of tuition.

I'm working here in the Senate to make grant aid more available and to improve education tax credits. I'd like to work with the university system to do more to improve access to college.

University endowments often provide funds to students who cannot otherwise pay. These endowments also have risen over the past decade.

There are more than 50 colleges and universities with endowments of more than $1 billion. These colleges represent a small portion of the entire higher education community. None of these colleges is in Montana.

Today we will look at how large endowments affect the cost of higher education. And how endowments can improve access to higher education.

We will follow Aristotle's advice. The legislators here will direct our attention above all to the education of youth. I look forward to hearing from our witnesses.

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United States Government Accountability Office

GAO

Testimony
Before the Committee on Finance,
U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EST
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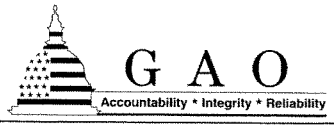
POSTSECONDARY EDUCATION

Multiple Tax Preferences and Title IV Student Aid Programs Create a Complex Education Financing Environment

Statement of Michael Brostek
Director, Tax Issues
Strategic Issues Team

George A. Scott
Acting Director
Education, Workforce, and Income Security Issues



GAO-07-262T

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-07-262T, testimony before the Committee on Finance, U.S. Senate

Why GAO Did This Study

Federal assistance helps students and families pay for postsecondary education through several policy tools—grant and loan programs authorized by title IV of the Higher Education Act of 1965 and more recently enacted tax preferences. This testimony summarizes and updates our 2005 report on (1) how title IV assistance compares to that provided through the tax code (2) the extent to which tax filers effectively use postsecondary tax preferences, and (3) what is known about the effectiveness of federal assistance.

This hearing is an opportunity to consider whether any changes should be made in the government's overall strategy for providing such assistance or to the individual programs and tax provisions that provide the assistance. This statement is based on previously published GAO work and reviews of relevant literature.

What GAO Recommends

GAO does not make new recommendations in this testimony. In 2002, GAO recommended, among other things, that the Department of Education sponsor research into key aspects of effectiveness of title IV programs. In April 2006, Education announced it would make multiyear grants available starting in 2007 to conduct research on topics addressed in this statement.

www.gao.gov/cgi-bin/getrpt?GAO-07-262T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9039 or George Scott at (202) 512-7215.

December 2006

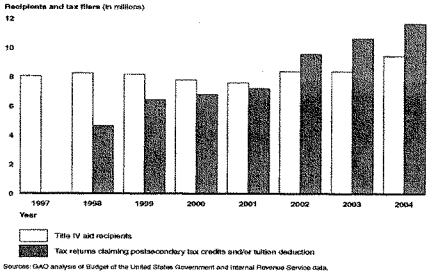
POSTSECONDARY EDUCATION

Multiple Tax Preferences and Title IV Student Aid Programs Create a Complex Education Financing Environment

What GAO Found

Title IV student aid and tax preferences provide assistance to a wide range of students and families in different ways. While both help students meet current expenses, tax preferences also assist students and families with saving for and repaying postsecondary costs. Both serve students and families with a range of incomes, but some forms of title IV aid—grant aid, in particular—provide assistance to those whose incomes are lower, on average, than is the case with tax preferences. Tax preferences require more responsibility on the part of students and families than title IV aid because taxpayers must identify applicable tax preferences, understand complex rules concerning their use, and correctly calculate and claim credits or deductions. While the tax preferences are a newer policy tool, the number of tax filers using them has grown quickly, surpassing the number of students aided under title IV in 2002.

Recipients of Title IV Assistance and Tax Filers Claiming an Education Tax Credit or Tuition Deduction, 1997-2004



Sources: GAO analysis of Budget of the United States Government and Internal Revenue Service data.

Some tax filers do not appear to make optimal education-related tax decisions. For example, among the limited number of 2002 tax returns available for our analysis, 27 percent of eligible tax filers did not claim either the tuition deduction or a tax credit. In so doing, these tax filers failed to reduce their tax liability by $169, on average, and 10 percent of these filers could have reduced their tax liability by over $500. One explanation for these taxpayers' choices may be the complexity of postsecondary tax provisions, which experts have commonly identified as difficult for tax filers to use.

Little is known about the effectiveness of title IV aid or tax preferences in promoting, for example, postsecondary attendance or school choice, in part because of research data and methodological challenges. As a result, policymakers do not have information that would allow them to make the most efficient use of limited federal resources to help students and families.

Chairman Grassley, Senator Baucus, and Members of the Committee:

We are pleased to be here this morning to discuss the federal government's efforts to financially support attendance at postsecondary education institutions. American higher education has long been crucial to the development of our nation's cultural, social, and economic capital. At the dawn of the 21st Century, changing workforce demographics, a more integrated global economy, and numerous technological advances are placing new demands on our colleges and universities. For the United States to remain competitive in the rising global knowledge economy, its citizens will need both the ways and means to endow themselves with the tools necessary for the task. However, rising tuition has become a disconcertingly fixed feature of our higher education system, and in recent months concerns about postsecondary access and affordability have received notable attention through the findings of the Secretary of Education's Commission on the Future of Higher Education and the Comptroller General's recent forum on the Global Competitiveness of the Nation's Higher Education System.

This hearing is an opportunity to consider whether any changes should be made in the government's overall strategy and the individual programs and tax provisions that provide financial assistance to students and families saving or paying for postsecondary education or repaying student loans. This opportunity to review the programs and tax provisions is important for several reasons. The fact that we face large and growing structural deficits in the future—primarily driven by demographics and rising health care costs—emphasizes the need to consider how the government allocates resources. In addition, GAO has noted that fundamental reexamination of government programs, policies, and priorities is necessary to assure that they match the needs of the 21st Century. GAO has identified the coordination of student aid programs[1] and the effectiveness of those programs[2] both as key topics needing congressional oversight.

My statement today will focus on three issues that emerged in our 2005 report on student grant and loan assistance made available under Title IV

[1]GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

[2] GAO, *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

of the Higher Education Act and postsecondary education tax preferences.[3]

- Postsecondary student financial assistance provided through programs authorized under title IV and the tax code differ in three key ways. First, title IV grant and loan programs traditionally provide aid to students and families while students are in college, whereas tax preferences help both during the college years as well as before and after college by assisting with saving for or repaying college costs. Additionally, while student aid programs and tax preferences serve students and families across a wide range of income groups, some title IV programs—particularly the Pell grant program—provide much of their financial assistance to students and families whose incomes are lower, on average, than students and families who receive student loans, tax credits, and deductions, or who make use of tax-exempt saving vehicles. Last, students and families have more responsibility for appropriately using and thereby obtaining the benefits of tax preferences than they do with title IV aid.
- Second, postsecondary tax preferences are difficult for families to understand and use correctly. Perhaps due to the complexity of the tax provisions, hundreds of thousands of taxpayers fail to claim tax preferences to which they are entitled or do not claim the tax preference that would be most advantageous to them.
- Finally, we found that Congress has received little evidence concerning the effectiveness of assistance provided under title IV or through tax preferences, including whether such assistance increases attendance or choice.

Our statement today is drawn from previous GAO reports and testimonies covering postsecondary title IV programs and tax preferences, which were done in accordance with generally accepted government auditing standards, as well as reviews of relevant literature.

Background

Financial assistance to help students and families pay for postsecondary education has been provided for many years through student grant and loan programs authorized under title IV of the Higher Education Act of 1965, as amended. Examples of these programs include Pell Grants for low-income students, PLUS loans to parents and graduate students, and

[3]See GAO, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families through Title IV Student Aid and Tax Preferences*, GAO-05-684 (Washington, D.C.: July 29, 2005).

Stafford loans.[4] Much of this aid has been provided on the basis of the difference between a student's cost of attendance and an estimate of the ability of the student and the student's family to pay these costs, called the expected family contribution (EFC). The EFC is calculated based on information provided by students and parents on the Free Application for Federal Student Aid (FAFSA). Statutory definitions establish the criteria that students must meet to be considered independent of their parents for the purpose of financial aid, and statutory formulas establish the share of income and assets that are expected to be available for the student's education.[5] In fiscal year 2005, the Department of Education made approximately $14 billion in grants, and title IV lending programs made available another $57 billion in loan assistance. Title IV also authorizes programs funded by the federal government and administered by participating higher education institutions, including the Supplemental Educational Opportunity Grant (SEOG), Perkins loans, and federal work-study aid, collectively known as campus-based aid. Table 1 provides brief descriptions of the title IV programs that we reviewed in our 2005 report and includes two programs—Academic Competitiveness Grants and National Science and Mathematics Access to Retain Talent Grants—that were created since that report was issued.[6]

[4]Consolidation loans are also authorized under title IV. These loans allow borrowers to combine multiple student loans, possibly from different lenders and from different loan programs, into a single new loan with extended repayment periods. Because consolidation loans do not generally result in an increase in loan principal, they are not addressed in this testimony.

[5]To be classified as an independent student for the purpose of receiving title IV financial aid, students must meet one of the following criteria: (1) be a veteran of the armed services, (2) be age 24 years or older by December 31st of the award year, (3) be married, (4) be enrolled in a graduate or professional education program, (5) have legal dependents other than a spouse, or (6) be an orphan or ward of the court. Financial aid administrators may also classify students as independent through the exercise of their professional judgment.

[6] For greater detail on federal spending through title IV postsecondary education assistance programs reviewed in our 2005 report, see app. I.

Table 1: Description of Federal Student Aid Programs Authorized under Title IV of the Higher Education Act

Title IV student aid program	Program description
Pell Grant	Grants are awarded on the basis of the difference between the EFC and the maximum Pell award or the student's cost of attendance, whichever is less. Grants are not available for postgraduate study.
Supplemental Educational Opportunity Grant	Schools administer grant funds, which are awarded to undergraduates with exceptional financial need; priority is given to Pell Grant recipients. Institutions must match a portion (at least 25 percent) of the federal funds allocated.
Academic Competitiveness Grant	Available to first- and second-year students who have completed a rigorous course of study in high school. To be eligible, students must also be eligible to receive a Pell Grant. Second-year students must also maintain at least a 3.0 grade-point average.
National Science and Mathematics Access to Retain Talent (SMART) Grant	Available to third- and fourth-year students pursuing a major in mathematics, science, or a foreign language deemed critical to national security. To be eligible, students must also be eligible to receive a Pell Grant and maintain at least a 3.0 grade-point average in their major.
Federal Work-Study	Schools administer funds, which are used to provide part-time jobs for undergraduate and graduate students with financial need. Participating schools or nonprofit employers generally contribute at least 25 percent of student's earnings (50 percent in the case of for-profit employers).
Federal Perkins Loan	Schools administer funds, comprised of federal capital contributions and school matching funds (at least 1/3 of federal contributions), to make low-interest (5 percent) loans for both undergraduate and graduate students with exceptional financial need. Borrower repayments are owed to the school.
Subsidized Federal Family Education Loan (FFEL) or Direct Stafford Loan	Loans made on the basis of financial need to undergraduate and graduate students who are enrolled at least half-time. The federal government pays the interest costs on subsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment.
Unsubsidized FFEL or Direct Stafford Loan	Loans made to undergraduate and graduate students who are enrolled at least half-time. Unlike subsidized loans, the federal government does not pay the interest costs on unsubsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment. Otherwise, the terms and conditions of unsubsidized loans are the same as those for subsidized loans.
FFEL or Direct PLUS Loan	Loans made to parents on behalf of dependent undergraduate students enrolled at least half-time. The Higher Education Reconciliation Act of 2005 makes both graduate and professional students eligible for these loans as well. Borrowers are subject to a credit check for adverse credit history and may be denied a loan.

Source: GAO analysis of applicable laws and regulations.

Postsecondary assistance also has been provided through a range of tax preferences,[7] including postsecondary tax credits, tax deductions, and tax-exempt savings programs. For example, the Taxpayer Relief Act of 1997 allows eligible tax filers to reduce their tax liability by receiving, for tax year 2006, up to a $1,650 Hope tax credit or up to a $2,000 Lifetime Learning tax credit for tuition and course-related fees paid for a single student. The fiscal year 2005 federal revenue loss estimate of the postsecondary tax preferences that we reviewed was $9.15 billion dollars. Tax preferences discussed as part of our 2005 report include the following:[8]

- Lifetime Learning Credit—income-based tax credit claimed by tax filers on behalf of students enrolled in one or more postsecondary education courses.
- Hope Credit—income-based tax credit claimed by tax filers on behalf of students enrolled at least half-time in an eligible program of study and who are in their first 2 years of postsecondary education.
- Student Loan Interest Deduction—income-based tax deduction claimed by tax filers on behalf of students who took out qualified student loans while enrolled at least half-time.
- Tuition and Fees Deduction—income-based tax deduction claimed by tax filers on behalf of students who are enrolled in one or more postsecondary education courses and have either a high school diploma or a General Educational Development (GED) credential.[9]
- Section 529 Qualified Tuition Programs—College Savings Programs and Prepaid Tuition Programs—non-income-based programs that provide favorable tax treatment to investments and distributions used to pay the expenses of future or current postsecondary students.
- Coverdell Education Savings Accounts—income-based savings program providing favorable tax treatment to investments and distributions used to pay the expenses of future or current elementary, secondary, or postsecondary students.

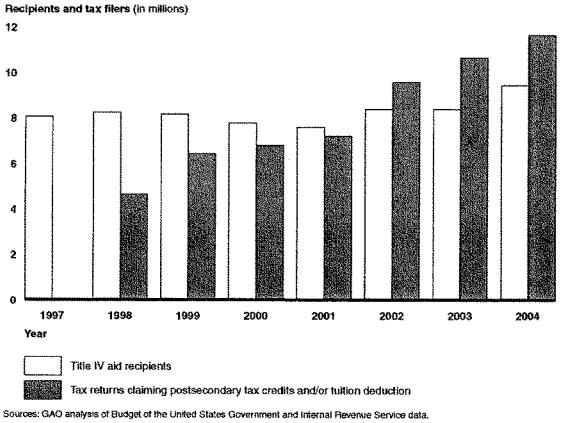
As figure 1 demonstrates, the use of tax preferences has increased since 1997, both in absolute terms and relative to the use of title IV aid.

[7] Tax preferences—also known as tax expenditures—are reductions in tax liabilities that result from preferential provisions in the tax code, such as exemptions and exclusions from taxation, deductions, credits, deferrals, and preferential tax rates.

[8] For expanded descriptions of postsecondary education-related tax preferences, see app. I.

[9] The Tuition and Fees Deduction expired on December 31, 2005. Legislation has been introduced to reinstate the deduction.

Figure 1: Recipients of Title IV Assistance and Tax Filers Claiming an Education Tax Credit or Tuition Deduction, 1997-2004



Sources: GAO analysis of Budget of the United States Government and Internal Revenue Service data.

Note: See app. IV for confidence intervals associated with these estimates.

Tax Preferences Differ from Title IV Assistance in Timing, Distribution, and Students' and Families' Responsibility for Obtaining Benefits

Postsecondary student financial assistance provided through programs authorized under title IV of the Higher Education Act and the tax code differ in timing of assistance, the populations that receive assistance, and the responsibility of students and families to obtain and use the assistance.

Title IV and Tax Programs Differ in Benefit Timing

Title IV programs and education-related tax preferences differ significantly in when eligibility is established and in the timing of the assistance they provide. Title IV programs generally provide benefits to students while they are in school. Education-related tax preferences, on the other hand, (1) encourage saving for college through tax-exempt saving, (2) assist enrolled students and their families in meeting the current costs of postsecondary education through credits and tuition deductions, and (3) assist students and families repaying the costs of past postsecondary education through a tax deduction for student loan interest paid.[10]

Beneficiaries of Title IV Programs and Tax Preferences Differ

While title IV programs and tax preferences assist many students and families, program and tax rules affect eligibility for such assistance. These rules also affect the distribution of title IV aid and the assistance provided through tax preferences. As a result, the beneficiaries of title IV programs and tax preferences differ.

Title IV programs generally have rules for calculating grant and loan assistance that give different consideration to family income, assets, and college costs in the award of financial aid.[11] For example, Pell Grant awards are calculated by subtracting the student's EFC from the maximum Pell Grant award ($4,050 in academic year 2006-2007), or the student's cost of attendance, whichever is less. Because the EFC is closely linked to family income and circumstances (such as the size of the family and the number of dependents in school), and modest EFCs are required for Pell eligibility, Pell awards are made primarily to families with modest incomes. In contrast, the maximum unsubsidized Stafford loan amount is calculated without direct consideration of financial need: students may borrow up to their cost of attendance, minus the estimated financial assistance they will receive.[12] As table 2 shows, 92 percent of Pell financial support in 2003-2004 was provided to dependent students whose family incomes were $40,000 or below, and the 38 percent of Pell recipients in the

[10] Additional details on the differences in timing are available in app. II.

[11] Campus-based aid programs authorized under title IV differ from these programs in funding and eligibility: institutions provide matching funding for federal spending, and participating institutions distribute aid using institution-specific criteria consistent with federal program requirements. Because they have institution-specific criteria, the relationship between program rules and the distribution of benefits is more complex and was excluded from the analysis of our 2005 report.

[12] Additionally, loan amounts for both subsidized and unsubsidized loans are subject to statutory limits on annual and cumulative borrowing.

lowest income category ($20,000 or below) received a higher share (48 percent) of Pell financial support.

Table 2: Percentage of Aid Recipients and Dollars of Aid by Income Category for Dependent Students Served by Selected Title IV Programs, 2003-2004

Program	Dependent students	$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	38	47	14	2	0	0
	Dollars	48	44	8	1	0	0
Stafford Subsidized Loan	Recipients	16	28	23	17	9	7
	Dollars	16	28	24	17	9	6
Stafford Unsubsidized Loan	Recipients	7	14	14	19	18	28
	Dollars	7	12	12	18	19	32

Source: GAO analysis of 2003-2004 NPSAS data.

Note: See app. IV for confidence intervals associated with these estimates. Numbers in rows may not add to 100 percent because of rounding.

Because independent students generally have lower incomes and accumulated savings than dependent students and their families, patterns of program participation and dollar distribution differ. Participation of independent students in Pell, subsidized Stafford, and unsubsidized Stafford loan programs is heavily concentrated among those with incomes of $40,000 or less: from 74 percent (unsubsidized Stafford) to 95 percent (Pell) of program participants have incomes below this level. As shown in table 3, the distribution of award dollars follows a nearly identical pattern.

Table 3: Percentage of Aid Recipients and Dollars of Aid by Income Category for Independent Students Served by Selected Title IV Programs, 2003-2004

Program	Independent students	$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	67	28	5	0	0	0
	Dollars	73	25	3	0	0	0
Stafford Subsidized Loan	Recipients	51	29	12	5	2	1
	Dollars	52	28	12	5	2	2
Stafford Unsubsidized Loan	Recipients	46	28	14	6	3	3
	Dollars	46	24	13	7	3	5

Source: GAO analysis of 2003-2004 NPSAS data.

Notes: See app. IV for confidence intervals associated with these estimates.

Numbers in rows may not add to 100 percent because of rounding.

Many education-related tax preferences have both de facto lower limits created by the need to have a positive tax liability to obtain their benefit and income ceilings on who may use them. For example, the Hope and Lifetime Learning tax credits require that tax filers have a positive tax liability to use them and income-related phase-out provisions in 2005 that began at $45,000 and $90,000 for single and joint filers, respectively. Furthermore, tax-exempt savings are more advantageous to families with higher incomes and tax liabilities because, among other reasons, these families hold greater assets to invest in these tax preferences and have a higher marginal tax rate, and thus benefit the most from the use of these tax preferences. Table 4 shows the income categories of tax filers claiming the three tax preferences available to current students and/or their families along with the reduced tax liabilities from those preferences in 2004.

Table 4: Percentage of Tax Filers Claiming Hope and Lifetime Learning Credits and Tuition Deduction and Tax Preference Dollars by Income Category, Tax Year 2004

Type of aid		$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Hope Credit	Tax filers	18	34	19	16	12	2
	Dollars	16	33	20	16	12	2
Lifetime Learning Credit	Tax filers	17	32	20	19	10	2
	Dollars	15	30	20	20	13	2
Tuition Deduction	Tax filers	24	13	15	10	13	25
	Dollars	11	7	18	12	15	37

Source: GAO analysis of 2004 SOI data.

Notes: See app. IV for confidence intervals associated with these estimates.

Numbers in rows may not add to 100 percent because of rounding.

Students and Families Have More Responsibility for Obtaining Benefits of Tax Preferences in Comparison to Title IV Aid

The federal government and postsecondary institutions have significant responsibilities in assisting students and families in obtaining assistance provided under title IV programs but only minor roles with respect to tax filers' use of education-related tax preferences. To obtain federal student aid, applicants must first complete the FAFSA, a form which required students to complete up to 100 fields in 2006-2007. Submitting a completed FAFSA to the Department of Education largely concludes students' and families' responsibility in obtaining aid. The Department of Education is responsible for calculating students' and families' EFC on the basis of the

FAFSA, and students' educational institutions are responsible for determining aid eligibility and the amounts and packaging of awards.

In contrast, higher education tax preferences require students and families to take more responsibility. Although postsecondary institutions provide students and IRS with information about higher education attendance, they have no other responsibilities for higher education tax credits, deductions, or tax-preferred savings. The federal government's primary role with respect to higher education tax preferences is the promulgation of rules; the provision of guidance to tax filers; and the processing of tax returns, including some checks on the accuracy of items reported on those tax returns. The responsibility for selecting among and properly using tax preferences rests with tax filers. Unlike title IV programs, users must understand the rules, identify applicable tax preferences, understand how these tax preferences interact with one another and with federal student aid, keep records sufficient to support their tax filing, and correctly claim the credit or deduction on their return.

Some Tax Filers May Not Effectively Use Postsecondary Tax Preferences, Possibly Due to Complexity

According to our analysis of IRS data on the use of Hope and Lifetime tax credits and the tuition deduction in our 2005 report, some tax filers appear to make less-than-optimal choices among them.[13] The apparent suboptimal use of postsecondary tax preferences may arise, in part, from the complexity of these provisions.

Some Tax Filers Appear to Make Suboptimal Choices

Making poor choices among tax preferences for postsecondary education may be costly to tax filers. For example, families may strand assets in a tax-exempt savings vehicle and incur tax penalties on their distribution if their child chooses not to go to college. They may also fail to minimize their federal income tax liability by claiming a tax credit or deduction that yields less of a reduction in taxes than a different tax preference or by failing to claim any of their available tax preferences. For example, if a married couple filing jointly with one dependent in his/her first 2 years of college had an adjusted gross income of $50,000, qualified expenses of $10,000 in 2006, and tax liability greater than $2,000, their tax liability

[13] Due to time constraints, we were unable to update these analyses for this testimony.

would be reduced by $2,000 if they claimed the Lifetime Learning credit but only $1,650 if they claimed the Hope credit.

In our 2005 report, we found that some people who appear to be eligible for tax credits and/or the tuition deduction did not claim them. The files of about 77 percent of the tax year 2002 tax returns that we were able to review were apparently eligible to claim one or more of the three tax preferences. However, about 27 percent of those returns, representing about 374,000 tax filers, failed to use the any of them. The amount by which these tax filers failed to reduce their tax averaged $169; 10 percent of this group could have reduced their tax liabilities by over $500.[14]

Suboptimal choices were not limited to tax filers who prepared their own tax returns. A possible indicator of the difficulty people face in understanding education-related tax preferences is how often the suboptimal choices we identified were found on tax returns prepared by paid tax preparers. We estimate that about 50 percent of the returns we found that appear to have failed to optimally reduce the tax filer's tax liability were prepared by paid tax preparers. Generalized to the population of tax returns we were able to review, returns prepared by paid tax preparers represent about 223,000 of the approximately 447,000 suboptimal choices we found. Our April 2006 study of paid tax preparers corroborated the problem of confusion over which of the tax preferences to claim.[15] Of the 9 undercover investigation visits we made to paid preparers with a taxpayer with a dependent college student, 3 preparers did not claim the credit most advantageous to the taxpayer and thereby cost these taxpayers hundreds of dollars in refunds. In our investigative scenario, the expenses and the year in school made the Hope education credit far more advantageous to the taxpayer than either the tuition and fees deduction or the Lifetime Learning credit.

The Suboptimal Use of Postsecondary Tax Preferences May Result from Their Complexity

The apparently suboptimal use of postsecondary tax preferences may arise, in part, because of the complexity of using these provisions. Tax policy analysts have frequently identified postsecondary tax preferences as a set of tax provisions that demand a particularly large investment of knowledge and skill on the part of students and families or expert

[14] Confidence intervals for all estimates in this section are included in appendix IV.

[15] GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

assistance purchased by those with the means to do so. They suggest that this complexity arises from multiple postsecondary tax preferences with similar purposes, from key definitions that vary across these provisions, and from rules that coordinate the use of multiple tax provisions. Twelve tax preferences are outlined in the IRS publication, Tax Benefits for Education, for use in preparing 2005 returns (the most recent publication available). The publication includes 4 different tax preferences for educational saving. Three of these preferences—Coverdell Education Savings Accounts, Qualified Tuition Programs, and U.S. education savings bonds—differ across more than a dozen dimensions, including the tax penalty that occurs when account balances are not used for qualified higher education expenses, who may be an eligible beneficiary, annual contribution limits, and other features.

In addition to learning about, comparing, and selecting tax preferences, filers who wish to make optimal use of multiple tax preferences must understand how the use of one tax preference affects the use of others. The use of multiple education-related tax preferences is coordinated through rules that prohibit the application of the same qualified higher education expenses for the same student to more than one education-related tax preference, sometimes referred to as "anti-double-dipping rules." These rules are important because they prevent tax filers from underreporting their tax liability. Nonetheless, anti-double-dipping rules are potentially difficult for tax filers to understand and apply, and misunderstanding them may have consequences for a filer's tax liability.[16]

Research on Effectiveness of Federal Postsecondary Assistance Is Incomplete

Little is known about the effectiveness of federal grant and loan programs and education-related tax preferences in promoting attendance, choice, and the likelihood that students either earn a degree or continue their education (referred to as persistence). Many federal aid programs and tax preferences have not been studied, and for those that have been studied, important aspects of their effectiveness remain unexamined. In our 2005 report, we found no research on any aspect of effectiveness for several major title IV federal postsecondary programs and tax preferences. For example, no research had examined the effects of federal postsecondary education tax credits on students' persistence in their studies or on the type of postsecondary institution they choose to attend. Gaps in the research-based evidence of federal postsecondary program effectiveness

[16]For an example of this phenomenon, please see app. III.

may be due, in part, to data and methodological challenges that have proven difficult to overcome. The relative newness of most of the tax preferences also presents challenges because relevant data are just now becoming available.

In 2002, we recommended that Education sponsor research into key aspects of effectiveness of title IV programs, that Education and the Department of the Treasury collaborate on such research into the relative effectiveness of title IV programs and tax preferences, and that the Secretaries of Education and Treasury collaborate in studying the combined effects of tax preferences and title IV aid.[17] In April 2006, Education's Institute for Education Sciences (IES) issued a Request for Applications to conduct research on, among other things, "evaluating the efficacy of programs, practices, or policies that are intended to improve access to, persistence in, or completion of postsecondary education." Multiyear projects funded under this subtopic are expected to begin in July 2007.

As we noted in our 2002 report, research into the effectiveness of different forms of postsecondary education assistance is important.[18] Without such information federal policymakers cannot make fact-based decisions about how to build on successful programs and make necessary changes to improve less effective programs. The budget deficit and other major fiscal challenges facing the nation necessitate rethinking the base of existing federal spending and tax programs, policies, and activities by reviewing their results and testing their continued relevance and relative priority for a changing society.[19]

Concluding Observations

In light of the long-term fiscal challenge this nation faces and the need to make hard decisions about how the federal government allocates resources, this hearing provides an opportunity to continue a discussion about how the federal government can best help students and their families pay for postsecondary education. Some questions that Congress should consider during this dialog include:

[17] GAO, *Student Aid and Tax Benefits: Better Research and Guidance Will Facilitate Comparison of Effectiveness and Student Use*, GAO-02-751 (Washington, D.C.: Sept. 13, 2002).

[18] GAO-02-751.

[19] GAO-05-325SP.

- Should the federal government consolidate postsecondary education tax provisions to make them easier for the public to use and understand?
- Given its limited resources, should the government further target title IV programs and tax provisions based on need or other factors?
- How can Congress best evaluate the effectiveness and efficiency of postsecondary education aid provided through the tax code?
- Can tax preferences and title IV programs be better coordinated to maximize their effectiveness?

Mr. Chairman and Members of the Committee, this concludes our statement. We welcome any questions you have at this time.

Staff Contacts and Acknowledgments

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Appendix I: Postsecondary Aid Programs

The federal government helps students and families save, pay for, and repay the costs of postsecondary education through grant and loan programs authorized under title IV of the Higher Education Act of 1965, and through tax preferences—reductions in federal tax liabilities that result from preferential provisions in the tax code, such as exemptions and exclusions from taxation, deductions, credits, deferrals, and preferential tax rates.

Federal Grant and Loan Assistance to Postsecondary Students

Assistance provided under title IV programs include Pell Grants for low-income students, the newly established Academic Competitiveness and National Science and Mathematics Access to Retain Talent Grants, PLUS loans, which parents as well as graduate and professional students may apply for, and Stafford loans.[1] While each of the three grant types reduces the price paid by the student, student loans help to finance the remaining costs and are to be repaid according to varying terms. Stafford loans may be either subsidized or unsubsidized. The federal government pays the interest cost on subsidized loans while the student is in school, and during a 6-month period known as the grace period, after the student leaves school. For unsubsidized loans, students are responsible for all interest costs.[2] Stafford and PLUS loans are provided to students through both the FFEL program and the William D. Ford Direct Loan Program (FDLP). The federal government's role in financing and administering these two loan programs differs significantly. Under the FFEL program, private lenders, such as banks, provide loan capital and make loans, and the federal government guarantees FFEL lenders a minimum yield on the loans they make and repayment if borrowers default. Under FDLP, federal funds are used as loan capital and loans are provided through participating schools.

[1]Consolidation loans are also authorized under title IV. These loans allow borrowers to combine multiple student loans, possibly from different lenders and from different loan programs, into a single new loan with extended repayment periods. Because consolidation loans do not generally result in an increase in loan principal, consolidation loans are not addressed in this review. However, the federal government can incur significant costs in providing borrowers with these loans. See GAO, *Student Loan Programs: As Federal Costs of Loan Consolidation Rise, Other Options Should Be Examined*, GAO-04-101 (Washington, D.C.: Oct. 31, 2003) and *Student Loan Programs: Lower Interest Rates and Higher Loan Volume Have Increased Federal Consolidation Loan Costs*, GAO-04-568T (Washington, D.C.: Mar. 17, 2004).

[2]While called "unsubsidized," the federal government can still incur costs on such loans, including the costs associated with borrowers who default on their loans and, under the Federal Family Education Loan Program, the costs of making payments to lenders to ensure them a minimum federally guaranteed yield.

The Department of Education and its private-sector contractors jointly administer the program. Title IV also authorizes programs funded by the federal government and administered by participating higher education institutions, including the Supplemental Educational Opportunity Grant (SEOG), Perkins loans, and federal work-study aid, collectively known as campus-based aid.

To receive title IV aid, students (along with parents, in the case of dependent students) must complete a Free Application for Federal Student Aid form. Information from the FAFSA, particularly income and asset information, is used to determine the amount of money—called the expected family contribution—that the student and/or family is expected to contribute to the student's education. Statutory definitions establish the criteria that students must meet to be considered independent of their parents for the purpose of financial aid, and statutory formulas establish the share of income and assets that are expected to be available for the student's education. Once the EFC is established, it is compared with the cost of attendance at the institution chosen by the student. The cost of attendance comprises tuition and fees; room and board; books and supplies; transportation; miscellaneous personal expenses; and, for some students, additional expenses.[3] If the EFC is greater than the cost of attendance, the student is not considered to have financial need, according to the federal aid methodology. If the cost of attendance is greater than the EFC, then the student is considered to have financial need. Title IV assistance that is made on the basis of the calculated need of aid applicants is called need-based aid. Key characteristics of title IV programs are summarized in table 5 below.

[3]These may include child care expenses for parents of young dependent children or supportive services for disabled students.

Table 5: Description of Federal Student Aid Programs Authorized under Title IV of the Higher Education Act

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
Pell Grant	Grants are awarded on the basis of the difference between the EFC and the maximum Pell award or the student's cost of attendance, whichever is less. Grants are not available for postgraduate study.	$400 to $4,050 for school year 2006-2007.	Dependent students: About 2.1 million grants were awarded in school year 2003-2004, totaling $5.3 billion. The average grant award was $2,573; the median income of recipients was $24,576. Independent students: About 3 million grants were awarded in school year 2003-2004, totaling $7.4 billion. The average grant award was $2,436; the median income of recipients was $12,925.
Supplemental Educational Opportunity Grant	Schools administer grant funds, which are awarded to undergraduates with exceptional financial need; priority is given to Pell Grant recipients. Institutions must match a portion (at least 25 percent) of the federal funds allocated.	$100 to $4,000.	Dependent students: About 554,000 grants were awarded in school year 2003-2004, totaling $494.2 million. The average grant award was $892; the median income of recipients was $22,827. Independent students: About 715,000 grants were awarded in school year 2003-2004, totaling $391.9 million. The average grant award was $548; the median income of recipients was $11,040.
Academic Competitiveness Grant	Available to first- and second-year students who have completed a rigorous course of study in high school. To be eligible, students must also be eligible to receive a Pell Grant. Second-year students must also maintain at least a 3.0 grade-point average.	$750 for first-year students and $1,300 for second year students.	Students: About 310,000 first-year grants and 110,000 second-year grants are expected to be awarded in school year 2006-2007, totaling an estimated $340.0 million. The average grant award is estimated to be $657 and $1,245 respectively.
National Science and Mathematics Access to Retain Talent (SMART) Grant	Available to third- and fourth-year students pursuing a major in mathematics, science, or a foreign language deemed critical to national security. To be eligible, students must also be eligible to receive a Pell Grant and maintain at least a 3.0 grade-point average in their major.	$4,000.	Students: About 40,000 third-year grants and 40,000 fourth-year grants are expected to be awarded in school year 2006-2007, totaling an estimated $310.0 million. The average grant award is estimated to be $3,718 and $3,875 respectively.

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
Federal Work-Study	Schools administer funds, which are used to provide part-time jobs for undergraduate and graduate students with financial need. Participating schools or nonprofit employers generally contribute at least 25 percent of student's earnings (50 percent in the case of for-profit employers).	Up to $300 more than the student's determined financial need; if employment continues past this point, federal funds may not be used to subsidize the employment.	Dependent students: About 1.1 million awards were awarded in school year 2003-2004, totaling $2 billion. The average award was $1,901; the median income of recipients was $46,441. Independent students: About 438,000 awards were awarded in school year 2003-2004, totaling $1 billion. The average award was $2,303; the median income of recipients was $10,561.
Federal Perkins Loan	Schools administer funds, comprised of federal capital contributions and school matching funds (at least 1/3 of federal contributions), to make low-interest (5 percent) loans for both undergraduate and graduate students with exceptional financial need. Borrower repayments are owed to the school.	$4,000 maximum for undergraduate students and $6,000 for graduate students; no minimum award amount. (Aggregate limits: $8,000 for undergraduates who have not completed 2 academic years; $20,000 for undergraduates who have completed 2 years; and, $40,000 for graduate students, including loans borrowed as an undergraduate.)	Dependent students: About 495,000 loans were made in school year 2003-2004, totaling $956 million. The average loan amount was $1,932; the median income of recipients was $39,175. Independent students: About 329,000 loans were made in school year 2003-2004, totaling $905.3 million. The average loan amount was $2,752; the median income of recipients was $10,277.
Subsidized FFEL or Direct Stafford Loan	Loans made on the basis of financial need to undergraduate and graduate students who are enrolled at least half-time. The federal government pays the interest costs on subsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment.	$2,625 to $8,500 depending upon year of schooling. Aggregate limits are $23,000 for undergraduates and $65,500 for graduate students.	Dependent students: About 2.6 million loans were made in school year 2003-2004, totaling $8.1 billion. The average loan amount was $3,188; the median income of recipients was $44,678. Independent students: About 3.8 million loans were made in school year 2003-2004, totaling $16.3 billion. The average loan amount was $4,340; the median income of recipients was $19,430.

Title IV student aid program	Program details	Annual award amounts	Number and characteristics of beneficiaries
Unsubsidized FFEL or Direct Stafford Loan[a]	Loans made to undergraduate and graduate students who are enrolled at least half-time. Unlike subsidized loans, the federal government does not pay the interest costs on unsubsidized loans while the student is in school, for the first 6 months after the student leaves school, and during a period of deferment. Otherwise, the terms and conditions of unsubsidized loans are the same as those for subsidized loans.	$2,625 to $18,500 depending on year of schooling (including any subsidized loan amounts received for the same period). Aggregate limits are $23,000 for dependent undergraduates, $46,000 for independent undergraduates, and $138,500 for graduate students.	Dependent students: About 1.6 million loans were made in school year 2003-2004, totaling $5.3 billion. The average loan amount was $3,293; the median income of recipients was $75,835. Independent students: About 3.3 million loans were made in school year 2003-2004, totaling $18.5 billion. The average loan amount was $5,671; the median income of recipients was $22,108.
FFEL or Direct PLUS Loan[a]	Loans made to parents on behalf of dependent undergraduate students enrolled at least half-time. The Higher Education Reconciliation Act of 2005 makes both graduate and professional students eligible for these loans as well. Borrowers are subject to a credit check for adverse credit history and may be denied a loan.	Maximum loan amounts are limited to cost of attendance less other federal, state, private, and institutional aid received for the period of enrollment.	About 634,000 loans were made in school year 2003-2004, totaling $5.7 billion. The average loan amount was $9,019; the median income of recipients was $71,397.

Source: GAO analysis of applicable laws and regulations and school year 2003-2004 NPSAS data.

[a]New slightly higher limits for these loans will take effect on July 1, 2007.

Tax Preferences

Prior to the 1990s, virtually all major federal initiatives to assist students with the costs of postsecondary education were provided through grant and loan programs authorized under title IV of the Higher Education Act. Since the 1990s, however, federal initiatives to assist families and students in paying for postsecondary education have largely been implemented through the federal tax code. The federal tax code now contains a range of tax preferences that may be used to assist students and families in saving for, paying, or repaying the costs of postsecondary education. These tax preferences include credits and deductions, both of which allow tax filers to use qualified higher education expenses to reduce their federal income tax liability. The tax credits reduce the tax filers' income tax liability on a dollar-for-dollar basis but are not refundable. Tax deductions permit qualified higher education expenses to be subtracted from income that would otherwise be taxable. To benefit from a higher education tax credit or tuition deduction, a tax filer must use tax form 1040 or 1040A, have an

adjusted gross income below the provisions' statutorily specified income limits, and have a positive tax liability after other deductions and credits are calculated, among other requirements.

Tax preferences also include tax-exempt savings vehicles. Section 529 of the tax code makes tax free the investment income from qualified tuition programs. There are two types of qualified tuition programs: savings programs established by states and prepaid tuition programs established either by states or by one or more eligible educational institutions. Another tax-exempt savings vehicle is the Coverdell Education Savings Account. Tax penalties apply to both 529 programs and Coverdell savings accounts if the funds are not used for allowable education expenses. Key features of these and other education-related tax preferences are described below, in table 6.

Table 6: Selected Postsecondary Education Tax Preferences

	Preference details				
Tax preference	**Eligibility**	**Income ranges for phasing out benefits (2006)a**	**Eligible expenses**	**Tax benefit (2006)**	**Number and characteristics of beneficiaries**
Hope Credit	Tax filer on behalf of self, spouse, or dependent who is working toward a degree or certificate at least half-time in the first 2 years of postsecondary enrollment.	Single filer: $45,000-$55,000 Joint return: $90,000-$110,000.b	Tuition and fees at institutions eligible to participate in title IV programs.	Maximum credit: $1,650 per student. Credit rate is 100 percent on first $1,100 of qualified higher education expenses, 50 percent on next $1,100.d Nonrefundable: if filer has no tax liability due to offsetting deductions, exemptions, or competing tax credits, filer cannot receive credit.	In tax year 2002, 3.3 million tax filers claimed $3.2 billion in Hope credits; the average credit claimed was $991, and the median income of filers claiming the credit was $39,203.

	Preference details				
Tax preference	**Eligibility**	**Income ranges for phasing out benefits (2006)a**	**Eligible expenses**	**Tax benefit (2006)**	**Number and characteristics of beneficiaries**
Lifetime Learning Credit	Tax filer on behalf of self, spouse, or dependent who is enrolled in undergraduate or graduate courses, or any course that aids in learning new or improving existing job skills, for as many years as the student is enrolled.	Single filer: $45,000-$55,000 Joint return: $90,000-$110,000.b	Tuition and fees at institutions eligible to participate in title IV programs.	Maximum credit: $2,000 per tax filer. (20 percent of qualified higher education expenses up to $10,000).d Nonrefundable: if filer has no tax liability due to offsetting deductions, exemptions, or competing tax credits, filer cannot receive credit.	In tax year 2002, 3.5 million tax filers claimed $1.7 billion in Lifetime Learning credits; the average credit claimed was $477, and the median income of filers claiming the credit was $39,706.
Student Loan Interest Deduction	Tax filer, on behalf of self, spouse, or dependent, available even to those who do not itemize interest paid. Student must have been enrolled at least half-time in a degree program.	Single filer: $50,000-$65,000 Joint return: $105,000-$135,000.c	Eligible loans are those used to pay for tuition, fees, room and board, and related expenses and include, for example, student loans provided under title IV.	Maximum deduction: $2,500 interest paid on eligible education loans is deductible.	In tax year 2002, 6.6 million tax filers deducted $892.6 million of student loan interest; the average deduction was $134, and the median income of filers deducting student loan interest was $43,544.
Section 529 qualified tuition programs—prepaid tuition programs and state-sponsored college savings programs	Specifics depend on particular program. Normally a prepaid program is open for contributions only on behalf of young children and accounts must be closed within some number of years after the beneficiary reaches college age. Generally, savings programs do not have age restrictions.	No phase-out.	Tuition, fees, books, supplies, and equipment required for attendance. Room and board if enrolled half-time or more.	No tax is due on a distribution from an account unless the amount distributed is greater than the beneficiary's adjusted qualified education expenses.	Section 529 qualified tuition programs—prepaid tuition programs and state-sponsored college savings programs

Tax preference	Preference details: Eligibility	Preference details: Income ranges for phasing out benefits (2006)a	Preference details: Eligible expenses	Tax benefit (2006)	Number and characteristics of beneficiaries
Coverdell Education Savings Accounts	Distributions can be used for students enrolled on full-time, half- time, or less than half-time basis. Account must be closed within 30 days after beneficiary reaches age 30.	For contributions, $95,000-$110,000 for single filers and $190,000-$220,000 for joint returns.	Tuition, fees, books, supplies, and equipment required for attendance. Room and board if enrolled half-time or more.	No tax is due on a distribution from an account unless the amount distributed is greater than the beneficiary's adjusted qualified education expenses. Annual contribution limit is $2,000 per year per student (through age 17).	Coverdell Education Savings Accounts
Tuition Deduction (expired Dec. 31, 2005)e	Same as Lifetime Learning credit.	Single filer: $65,000-80,000 Joint Return: $130,000-160,000.	Tuition and fees at institutions eligible to participate in title IV programs.	Maximum deduction: $4,000 per return for individual filers whose modified adjusted gross income is less than $65,000 ($130,000 for joint filers); $2,000 per return for individuals whose modified adjusted gross income is more than $65,000 ($130,000) but less than $80,000 ($160,000).	Tuition Deduction (expired Dec. 31, 2005)e

Sources: IRS, Investment Company Institute, and College Savings Plan Network documents; GAO analysis of IRS Statistics of Income data for tax year 2002.

[a] Modified adjusted gross income amounts are provided.

[b] Under the Taxpayer Relief Act of 1997, the income phase-out amounts are indexed to inflation according to a formula specified in law for this purpose, which may or may not result in a yearly increase.

[c] Under the 26 U.S.C. § 221(f), the income phase-out amounts are indexed to inflation according to a formula specified in law for this purpose, which may or may not result in a yearly increase.

[d] For students attending otherwise eligible educational institutions located within the Gulf Opportunity Zone, the maximum Hope tax credit and maximum Lifetime Learning tax credit are doubled for taxable years 2005 and 2006. Gulf Opportunity Zone Act, Pub. L. No. 109-135, § 102, 119 Stat. 2577, 2594 (2005).

[e] Although the tuition deduction has expired, H.R. 5970, 109th Cong. § 201 (2006), among other bills, would renew the deduction for tuition expenses through December 31, 2007. H.R. 5970 passed in the House on July 29, 2006, but had not yet passed the Senate.

Our review of tax preferences did not include exclusions from income, which permit certain types of education-related income to be excluded from the calculation of adjusted gross income on which taxes are based. For example, qualified scholarships covering tuition and fees and qualified

tuition reductions from eligible educational institutions are not included in gross income for income tax purposes. Similarly, student loans forgiven when a graduate goes into certain professions for a certain period of time are also not subject to federal income taxes. We also did not include special provisions in the tax code that also extend existing tax preferences when tax filers support a postsecondary education student. For example, tax filers may claim postsecondary education students as dependents after age 18, even if the student has his or her own income over the limit that would otherwise apply. Also, gift taxes do not apply to funds used for certain postsecondary educational expenses, even for amounts in excess of the usual $11,000 limit on gifts. In addition, funds withdrawn early from an Individual Retirement Account are not subject to the usual 10 percent penalty when used for either a tax filer's or his or her dependent's postsecondary educational expenses.

Appendix II: Comparison of Assistance by Timing of Benefit for Selected Programs and Tax Preferences

Table 7: Comparison of Assistance by Timing of Benefit for Selected Programs and Tax Preferences

Type of assistance	Save for future expenses	Pay current expenses	Repay expenses
Grant programs		Pell Grants Supplemental Educational Opportunity Grants Academic Competitiveness Grants SMART Grants	
Loan programs		Subsidized and Unsubsidized Stafford Loans Federal Perkins Loans Federal PLUS Loans	
Tax preferences	Coverdell Educational Savings Accounts and Section 529 Qualified Tuition Programs	Hope Credit Lifetime Learning Credit Tuition Deduction	Student Loan Interest Deduction
Work-Study program		Federal Work Study	

Source: GAO.

Appendix III: Effects of Tax Rules on Tax Preference Use

For an example of how the use of college savings programs and the tuition deduction is affected by "anti-double-dipping" rules, consider the following: To calculate whether a distribution from a college savings program is taxable, tax filers must determine if the total distributions for the tax year are more or less than the total qualified educational expenses reduced by any tax-free educational assistance, i.e., their adjusted qualified education expenses (AQEE). After subtracting tax-free assistance from qualified educational expenses to arrive at the AQEE, tax filers multiply total distributed earnings by the fraction (AQEE / total amount distributed during the year). If parents of a dependent student paid $6,500 in qualified education expenses from a $3,000 tax-free scholarship and a $3,600 distribution from a tuition savings program, they would have $3,500 in AQEE. If $1,200 of the distribution consisted of earnings, then $1,200 x ($3,500 AQEE / $3,600 distribution) would result in $1,167 of the earnings being tax free, while $33 would be taxable. However, if the same tax filer had also claimed a tuition deduction, anti-double-dipping rules would require the tax filer to subtract the expenses taken into account in figuring the tuition deduction from AQEE. If $2,000 in expenses had been used toward the tuition deduction, then the taxable distribution from the section 529 savings program would rise to $700.[1] For families such as these, anti-double-dipping rules increase the computational complexity they face and may result in unanticipated tax liabilities associated with the use of section 529 savings programs.

[1]The new nontaxable distribution figure is calculated $1,200 x ($1,500/$3,600) = $500. The taxable portion then becomes $1,200 - $500 = $700.

Appendix IV: Confidence Intervals

We used two data sets for this testimony: Education's 2003-2004 National Postsecondary Student Aid Study and the Internal Revenue Service's 2002 and 2004 Statistics of Income. Estimates from both data sets are subject to sampling errors and the estimates we report are surrounded by a 95 percent confidence interval. The following tables provide the lower and upper bounds of the 95 percent confidence interval for all estimate figures in the tables in this testimony. For figures drawn from these data, we provide both point estimates and confidence intervals.

Table 8: Federal Student Aid Programs Authorized under Title IV of the Higher Education Act, Academic Year 2003-2004

	Number of recipients		Total award		Average award		Median income	
Type of assistance	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound
Dependent students								
Pell Grant	2,026,011	2,115,312	5,201,091,600	5,452,845,564	2,543	2,573	24,165	24,999
Supplemental Educational Opportunity Grant	530,408	577,316	466,079,305	522,325,472	857	892	22,022	23,484
Federal Work- Study	1,023,755	1,089,687	1,927,247,135	2,090,819,033	1,856	1,901	45,000	48,231
Federal Perkins Loan	472,640	517,207	907,800,538	1,004,290,295	1,887	1,932	37,623	40,814
Subsidized FFEL or Direct Stafford Loan	2,505,118	2,604,668	7,962,531,788	8,329,729,995	3,155	3,188	43,834	45,446
Unsubsidized FFEL or Direct Stafford Loan	1,578,160	1,664,757	5,173,481,648	5,505,576,910	3,244	3,293	74,263	77,439
FFEL or Direct PLUS Loan	609,125	659,071	5,458,550,634	5,979,275,038	8,787	9,019	69,547	73,439
Independent students								
Pell Grant	2,967,340	3,087,638	7,212,123,299	7,540,282,035	2,409	2,436	12,614	13,262
Supplemental Educational Opportunity Grant	684,528	745,839	368,492,546	415,343,758	526	548	10,425	11,626
Federal Work- Study	676,216	766,317	933,916,755	1,084,530,206	2,192	2,303	9,808	11,525
Federal Perkins Loan	522,918	595,499	839,749,704	970,851,318	2,648	2,752	9,181	11,628
Subsidized FFEL or Direct Stafford Loan	3,658,692	3,869,237	15,604,880,694	17,068,144,196	4,244	4,340	18,754	20,148
Unsubsidized FFEL or Direct Stafford Loan	3,154,948	3,359,231	17,728,962,613	19,212,909,259	5,531	5,671	21,190	23,095
FFEL or Direct PLUS Loan	0	0	0	0	0	0	0	0

Source: GAO analysis of 2003-2004 National Postsecondary Student Aid Study data.

Table 9: Selected Postsecondary Education Tax Preferences, Tax Year 2002

	Number of returns		Total benefits		Average benefit		Median income	
Type of assistance	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound
Hope Credit	3,115,595	3,414,023	3,064,601,005	3,399,426,275	965	1,016	37,506	41,004
Lifetime Learning Credit	3,307,354	3,612,179	1,560,825,683	1,740,857,453	462	493	38,060	41,001
Student Loan Interest Deduction	6,432,399	6,849,170	848,115,632	937,085,664	129	140	42,378	44,657
Tuition Deduction	3,295,741	3,599,012	1,226,452,349	1,370,953,823	364	391	51,808	56,842

Source: GAO analysis of Statistics of Income data for 2002.

Table 10: Tax Filers Claiming an Education Tax Credit or Tuition Deduction

		1998	1999	2000	2001	2002	2003	2004
Hope Credit, Lifetime Learning Credit, and Tuition Deduction	Lower bound	4,482,106	6,233,732	6,606,583	6,997,019	9,319,692	10,370,110	11,360,283
	Upper bound	4,827,719	6,639,576	7,024,049	7,428,088	9,809,833	10,882,359	11,892,067

Source: GAO analysis of Statistics of Income data.

Table 11: Percentage of Aid Recipients and Dollars of Aid by Income Category for Dependent Students Served by Selected Title IV Programs, School Year 2003-2004

Program	Dependent students		$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	Lower bound	36.66	45.41	13.17	1.41	0	0
		Upper bound	38.89	47.72	14.76	2.02	0	0
	Dollars	Lower bound	46.29	42.41	7.38	0.65	0	0
		Upper bound	48.82	44.89	8.5	1.04	0	0
Stafford Subsidized Loan	Recipients	Lower bound	15.41	26.79	22.45	16.1	8.38	6.23
		Upper bound	16.94	28.73	24.3	17.72	9.61	7.33
	Dollars	Lower bound	15.32	27.14	22.83	15.68	7.92	5.87
		Upper bound	17.07	29.35	24.94	17.51	9.3	7.08
Stafford Unsubsidized Loan	Recipients	Lower bound	6.51	12.83	13.15	17.69	16.68	27
		Upper bound	7.88	14.76	15.21	19.94	18.84	29.5
	Dollars	Lower bound	6.22	11.05	11.31	16.69	17.55	30.3
		Upper bound	7.75	12.99	13.41	19.2	20.15	33.37

Source: GAO analysis of 2003-2004 National Postsecondary Student Aid Study data.

Table 12: Percentage of Aid Recipients and Dollars of Aid by Income Category for Independent Students Served by Selected Title IV Programs, Academic Year 2003-2004

Program			$0- 20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Pell Grant	Recipients	Lower bound	66.28	26.59	4.59	0	0	0
		Upper bound	68.35	28.57	5.62	0	0	0
	Dollars	Lower bound	71.68	23.62	2.32	0	0	0
		Upper bound	73.77	25.65	2.96	0	0	0
Stafford Subsidized Loan	Recipients	Lower bound	49.67	27.54	10.78	4.04	1.3	0.86
		Upper bound	52.62	30.38	13.48	5.36	1.98	2.38
	Dollars	Lower bound	49.93	25.26	10.05	3.87	1.2	0.46
		Upper bound	54.61	29.79	14.73	5.4	2.05	2.65
Stafford Unsubsidized Loan	Recipients	Lower bound	44.65	26.59	12.09	5.48	2.31	2.26
		Upper bound	47.82	29.75	15.18	6.87	3.18	4.08
	Dollars	Lower bound	44.28	22.51	11.96	6.22	2.86	3.42
		Upper bound	48.37	26	14.78	8.49	4.12	6.99

Source: GAO analysis of 2003-2004 National Postsecondary Student Aid Study data.

Table 13 Percentage of Tax Filers Claiming Hope and Lifetime Learning Credits and Tuition Deduction and Tax Preference Dollars by Income Category, Tax Year 2004

Type of aid			$0-20,000	$20,001-40,000	$40,001-60,000	$60,001-80,000	$80,001-100,000	More than $100,000
Hope Credit	Tax filers	Lower bound	16.5	31.4	17	14.3	10.4	1.2
		Upper bound	20.1	35.7	20.4	17.6	13.3	2
	Dollars	Lower bound	14.7	30.6	18.1	14.6	10.7	1.4
		Upper bound	18.2	35.2	22.1	18.2	13.9	2.3
Lifetime Learning Credit	Tax filers	Lower bound	15.5	30.3	18.7	17.5	8.3	1.4
		Upper bound	18.6	34.1	21.9	20.7	10.7	2.2
	Dollars	Lower bound	13.2	28	17.5	17.4	11.1	1.7
		Upper bound	16.9	32.9	21.7	21.7	14.8	3
Tuition Deduction	Tax filers	Lower bound	21.9	11.4	13.6	9.3	11.9	23.6
		Upper bound	25.1	13.9	16.3	11.7	14.5	26.7
	Dollars	Lower bound	10	5.8	16.2	9.9	13.5	34.5
		Upper bound	12.1	7.6	20.4	13.4	17.2	39.5

Source: GAO analysis of Statistics of Income data for 2004.

Table 14: Percentage of Form 1098-Ts with Postsecondary Expense Information in 2002: Point Estimates

	Number of returns	Percent of returns
1098Ts with expense information	1,795,180	13
1098Ts without expense information	12,356,444	87

Source: GAO analysis of Statistics of Income data for 2002.

Table 15: Percentage of Form 1098-Ts with Postsecondary Expense Information in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
1098Ts with expense information	1,687,744.88	1,902,614.62	11.97	13.4
1098Ts without expense information	12,087,410.46	12,625,476.86	86.6	88.03

Source: GAO analysis of Statistics of Income data for 2002.

Table 16: Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction in 2002: Point Estimates

	Number of returns	Percent of returns
Total	1,795,180	100
Potentially eligible	1,386,659	77
All other	408,521	23

Source: GAO analysis of Statistics of Income data for 2002.

Table 17: Percentage of Taxpayers Apparently Eligible to Claim an Education Tax Credit or Tuition Deduction in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Total	1,795,176.75	1,795,179.75	100	100
Potentially eligible	1,290,394.34	1,482,923.26	74.83	79.66
All other	360,292.26	456,749.64	20.34	25.17

Source: GAO analysis of Statistics of Income data for 2002.

Table 18: Percentage of Apparently Eligible Taxpayers to Claim an Education Tax Credit or Tuition Deduction That Failed to Do So in 2002: Point Estimates

	Number of returns	Percent of returns
Failed to claim	373,595	27

Source: GAO analysis of Statistics of Income data for 2002.

Table 19: Percentage of Apparently Eligible Taxpayers to Claim an Education Tax Credit or Tuition Deduction That Failed to Do So in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Failed to claim	323,504.26	423,686.08	23.85	30.04

Source: GAO analysis of Statistics of Income data for 2002.

Table 20: Amounts by Which Apparently Eligible Taxpayers Failed to Reduce Their Tax Liability in 2002: Point Estimates

	Inaction led to increased tax liability
Median	52.45
Mean	168.66
10th percentile	4.34
25th percentile	10.94
75th percentile	207.2
90th percentile	532.96
Maximum value	1,116

Source: GAO analysis of Statistics of Income data for 2002.

Table 21: Amounts by Which Apparently Eligible Taxpayers Failed to Reduce Their Tax Liability in 2002: Confidence Intervals

	Inaction led to increased tax liability
Median: Lower bound	34.69
Median: Upper bound	73.57
Mean: Lower bound	136.57
Mean: Upper bound	200.76
10th percentile: Lower bound	3.01
10th percentile: Upper bound	6.57
25th percentile: Lower bound	8.66
25th percentile: Upper bound	16.72
75th percentile: Lower bound	137.73
75th percentile: Upper bound	312.14
90th percentile: Lower bound	429.22
90th percentile: Upper bound	729.58

Source: GAO analysis of Statistics of Income data for 2002.

Table 22: Percentage of Apparently Eligible Taxpayers That Claimed the Tuition Deduction but Would Have Been Better off Claiming the Lifetime Learning Credit in 2002: Point Estimates

	Number of returns	Percent of returns
Would have been better off claiming Lifetime Learning Credit	50,908	21

Source: GAO analysis of Statistics of Income data for 2002.

Table 23: Percentage of Apparently Eligible Taxpayers That Claimed the Tuition Deduction but Would Have Been Better off Claiming the Lifetime Learning Credit in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Would have been better off claiming Lifetime Learning Credit	34,819.89	70,274.77	14.53	29.33

Source: GAO analysis of Statistics of Income data for 2002.

Table 24: Amounts by Which Apparently Eligible Taxpayers Could Have Reduced Their Tax Liability in 2002: Point Estimates

	Lifetime Learning Credit produced larger reduction
Median	50.67
Mean	83.22
10th percentile	7.35
25th percentile	26.23
75th percentile	119.6
90th percentile	157.91
Maximum value	556

Source: GAO analysis of Statistics of Income data for 2002.

Table 25: Amounts by Which Apparently Eligible Taxpayers Could Have Reduced Their Tax Liability in 2002: Confidence Intervals

	Lifetime Learning Credit produced larger reduction
Median: Lower bound	32.89
Median: Upper bound	84.27
Mean: Lower bound	49.76
Mean: Upper bound	116.68
10th percentile: Lower bound	.
10th percentile: Upper bound	27.14
25th percentile: Lower bound	10.7
25th percentile: Upper bound	47.56
75th percentile: Lower bound	62.07
75th percentile: Upper bound	148.53
90th percentile: Lower bound	106.35
90th percentile: Upper bound	.

Source: GAO analysis of Statistics of Income data for 2002.

Table 26: Percentage of Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit but Would Have Been Better off Claiming the Tuition Deduction in 2002: Point Estimates

	Number of returns	Percent of returns
Would have been better off claiming the Tuition Deduction	22,469	8

Source: GAO analysis of Statistics of Income data for 2002.

Table 27: Percentage of Apparently Eligible Taxpayers That Claimed the Lifetime Learning Credit but Would Have Been Better off Claiming the Tuition Deduction in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Would have been better off claiming the Tuition Deduction	12,228.08	37,165.3	4.48	13.61

Source: GAO analysis of Statistics of Income data for 2002.

Table 28: Amounts by Which Apparently Eligible Taxpayers Could Have Reduced Their Tax Liability in 2002: Point Estimates

	Tuition deduction produced larger reduction
Median	108.05
Mean	137.68
10th percentile	17.3
25th percentile	36.42
75th percentile	191.55
90th percentile	237.42
Maximum value	456

Source: GAO analysis of Statistics of Income data for 2002.

Table 29: Amounts by Which Apparently Eligible Taxpayers Could Have Reduced Their Tax Liability in 2002: Confidence Intervals

	Deduction produced larger reduction
Median: Lower bound	37.39
Median: Upper bound	190.77
Mean: Lower bound	77.08
Mean: Upper bound	198.28
10th percentile: Lower bound	4.36
10th percentile: Upper bound	41.46
25th percentile: Lower bound	20.16
25th percentile: Upper bound	108.84
75th percentile: Lower bound	107.3
75th percentile: Upper bound	244.85
90th percentile: Lower bound	154.73
90th percentile: Upper bound	350.13

Source: GAO analysis of Statistics of Income data for 2002.

Table 30: Percentage of Apparently Eligible Taxpayers That Claimed a Hope Credit but Would Have Been Better off Claiming a Lifetime Learning Credit in 2002: Point Estimates

	Number of returns	Percent of returns
Total	271,494	100
Would have been better off claiming Lifetime Learning Credit	0	0
All other	271,494	100

Source: GAO analysis of Statistics of Income data for 2002.

Table 31: Percentage of Apparently Eligible Taxpayers That Claimed a Hope Credit but Would Have Been Better off Claiming a Lifetime Learning Credit in 2002: Confidence Intervals

	Number of returns: Lower bound	Number of returns: Upper bound	Percent of returns: Lower bound	Percent of returns: Upper bound
Total	271,491.04	271,494.04	100	100
Would have been better off claiming Lifetime Learning Credit	0	0	0	0
All other	271,491.04	271,494.04	100	100

Source: GAO analysis of Statistics of Income data for 2002.

Table 32: Percentage of Suboptimal Choices Made by Paid Tax Preparers in 2002: Point Estimates

	Taxpayers making suboptimal choice	
	Number of returns	Percent
Total	446,972	100
No preparer	219,139	49.03
Paid preparer	223,011	49.89
IRS prepared/reviewed	0	0
VITA/self help/outreach/elderly assistance	4,822	1.08

Source: GAO analysis of Statistics of Income data for 2002.

Table 33: Percentage of Suboptimal Choices Made by Paid Tax Preparers in 2002: Confidence Intervals

	Taxpayers making suboptimal choice			
	Number of returns: Lower bound	Number of returns: Upper bound	Percent: Lower bound	Percent: Lower bound
Total	392,039	501,905	99.72	100
No preparer	179,777	258,500	42.87	55.19
Paid preparer	184,952	261,070	43.74	56.05
IRS prepared/reviewed	0	0	0	0.28
VITA/self help/outreach/elderly assistance	1,131	9,328	0.26	2.91

Source: GAO analysis of Statistics of Income data for 2002.

Responses to Questions for the Record From Michael Brostek
Senate Finance Committee Hearing of December 5, 2006

1. Please comment on Dr. Dynarski's proposal to combine the Pell Grant and HOPE Scholarship/Lifetime Education Tax Credits into one refundable education tax credit.

Many researchers and policy analysts have supported simplifying existing student grants, loans and tax preferences in the belief that doing so would have a net benefit on encouraging access. The Dynarski proposal seeks a similar objective; a point made clear in Dr. Dynarski's testimony before the Senate Finance Committee. Her suggestion to merge the Pell Grant and education tax credits into a combined credit is outlined in greater detail in one of her most recent publications, "The Feasibility of Streamlining Aid for College Using the Tax System.[1]" This paper puts forth the following application process and aid delivery mechanism: (1) families would apply for a combined grant/tax credit by checking off a box on their income tax form, (2) the Internal Revenue Service (IRS) would provide to the Department of Education (Education) information on applicants' adjusted gross income, dependency status, and number of dependents, (3) Education would calculate grant eligibility based on the data supplied by IRS and send students vouchers, (4) students would notify schools of their grant eligibility in applying for admission, (5) schools would electronically verify students' enrollment status for Education, and (6) Education would verify schools' eligibility for participating in the grant program. Once eligibility is confirmed, Education would deliver funds directly to the school.

Applying for a combined Pell Grant and tax credit, as proposed by Dr. Dynarski, could address some of the challenges GAO has previously identified regarding tax filers' use of postsecondary tax preferences. For example, in our 2005 report on postsecondary education programs we found that some students and families made sub-optimal decisions when choosing from the currently available postsecondary education tax preferences and that the different requirements for the different tax preferences could confuse taxpayers.[2] Reducing the number of choices students and their families have to make would, consequently, reduce tax filers' confusion and mistakes. Similarly, we also noted in our report that the interaction between tax preferences and direct student aid programs such as the Pell Grant could also create confusion for students and families. Combining tax preferences and grant aid would also address these issues.

While potentially offering benefits, Congress would likely want to carefully consider several aspects of such a proposal. These include:

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[1] Susan M. Dynarski and Judith E. Scott-Clayton, "The Feasibility of Streamlining Aid for College Using the Tax System" (paper presented at the National Tax Association Annual Conference, November 17, 2006).
[2] GAO, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families through Title IV Student Aid and Tax Preferences*, GAO-05-684 (Washington, D.C.: July 29, 2005).

a) The current system is used by more parties than just the federal government and is also used for federal funding programs other than need-based grant aid. The current Free Application for Federal Student Aid (FAFSA), which students and families use to apply for Pell Grants, is also used to determine students' eligibility for other federal aid programs, including Stafford and PLUS loans, Supplemental Educational Opportunity Grants (SEOG), Perkins Loans, and Federal Work-Study. In addition, many states and schools rely on the FAFSA when awarding state and institutional student aid. (The first page of the FAFSA lists states' filing deadlines of the form for the purpose of state aid programs, which, for the 2007-2008 award year range from March 1, 2007 to June 30, 2008). As such, a better understanding is first needed about whether and to what extent the Dynarski proposal would: 1) alter the administration of other federal, state and institutional student aid programs, 2) be capable of accommodating future federal policies designed to target aid, and 3) affect current programs that are specifically tied to Pell Grant eligibility, i.e., the recently-established Academic Competitiveness and National Science and Mathematics Access to Retain Talent (SMART) Grants. While the Dynarski proposal offers a number of simplifications to the current system, it does not address how the administration and distribution of other federal, state and institutional aid programs might also be affected. To the extent that other programs required FAFSA-like information from applicants to award financial aid, the net effect could be an increase in the number of applications students and families would be required to submit.

b) A more thorough accounting of the program's eventual costs is needed. The cost estimates for the Dynarski proposal are based solely on analyses of undergraduate students. Because graduate students are also currently eligible to take the Lifetime Learning tax credit, Congress would need to determine whether such students would continue to remain eligible and how their inclusion would affect cost estimates. In addition, the estimate of $2.8-billion in additional funding needed to implement her proposal is based on a maximum Pell Grant award of $4,050 and no new students entering higher education as a result of the proposed policy. It is unclear both how, and to what extent, changes in these factors could affect federal costs. In addition, Dr. Dynarski's paper does not clarify which agency—IRS or Education—would assume federal budgeting and accounting responsibilities.

c) Grant aid for some students may exceed annual tuition costs. In contrast to the current system, the Dynarski proposal makes the combined credit's value independent of both the Expected Family Contribution (EFC), which is calculated based on information provided on the FAFSA, and the school a student chooses to attend. In cases where students receiving the maximum credit choose to attend community colleges (which Dr. Dynarski argues is the student/institution combination that would be most affected by this program), annual grant aid may exceed the annual cost of attendance.[3] Such a scenario leads to two subsequent policy choices: 1) reducing the grant award to the annual cost of attendance, or 2) providing the student with the balance of the award. Reducing the grant award under such circumstances would reduce Dr. Dynarski's program cost estimate. With respect to the second option, policymakers would need to consider the potential incentives for low-cost institutions to raise their tuition rates and for some students to enroll in lower-cost institutions. In addition, policymakers would also need to consider costs associated with the federal government recovering funds if a student failed

[3] This is likely to be most applicable to those students who attend community colleges and live in their parents' home.

to maintain enrollment for an entire academic year, as pointed out by Mr. Brostek of the GAO at the same Senate Finance Committee hearing. Based upon the more detailed description of Dr. Dynarski's proposal presented in her paper, one option to address this issue could include, given that Dr. Dynarski envisions schools delivering funds to students, making schools responsible for disbursing aid over the course of the school year, contingent on students' continued enrollment. For example, school officials could disburse a portion of the aid to the student at the beginning of each semester.

d) Possible compliance issues associated with program design. Policymakers would also want to consider potential compliance issues related to program design. For example, using the information presented in Exhibit 1 of Dr. Dynarski's paper, the increase in a student's annual grant based on a change in their parents' adjusted gross income (AGI) can be calculated as shown in the table below. The results illustrate that as family AGI increases, so too do the gains in grant aid from reducing family AGI by $5,001. Though the gains decline after family AGI reaches $45,000, the nominal dollar benefit still exceeds that which can be achieved by families whose AGI is $30,000 or less. This suggests that such a program structure may possibly reduce federal tax revenues by providing some tax filers with an incentive to adjust their AGI so as to maximize their grant aid.

Gain in Aid from a $5,001 Decrease in Adjusted Gross Income (AGI)

Reduction in AGI			Annual
From	To	% Change in AGI	Grant Increase
$20,000	$14,999	25.0%	$750
$25,000	$19,999	20.0%	$700
$30,000	$24,999	16.7%	$900
$35,000	$29,999	14.3%	$1,400
$40,000	$34,999	12.5%	$1,600
$45,000	$39,999	11.1%	$1,000
$50,000	$44,999	10.0%	$350

2. Regarding a refundable education tax credit or grant increase, would it be feasible to include an allowance for room and board? If so, please provide insight into its administration.

Room and board expenses are currently considered in the administration of the federal student aid programs authorized under Title IV of the Higher Education Act. Most federal aid as well as some state and institutional aid is awarded based on the student's cost of attendance less the student's and/or family's ability to pay these costs—known as the expected family contribution (EFC). Schools develop estimates of room, board and other expenses, in addition to tuition, to

determine the amount of aid for which students are eligible. Room and board expenses can vary based on where a school is located as well as whether a student lives on or off campus.

Room and board expenses can be a significant component of a student's cost of attendance, particularly at community colleges (the institutions that Dr. Dynarski believes would be most affected by her proposal). Such expenses could be included as an eligible expense for a tax credit or a combined credit. Using a standard allowance, rather than accounting for actual expenses could lessen recordkeeping requirements for tax filers and result in fewer tax filer compliance issues than would be associated with using actual expenses. However, particular attention would need to be given to the precise level at which such an allowance would be set. Establishing too high an allowance could result in some students receiving a benefit in excess of the costs they incur for room and board, especially for those students who chose to live with their parents. Though Dr. Dynarski does not address this issue in her paper, perhaps Education could coordinate with institutions in determining the amount of a student's benefit. As described by Dr. Dynarski, Education would deliver aid funds to schools; hence schools could limit the amount of funds disbursed such that aid amounts did not exceed a student's total cost of attendance.

3. Please discuss options to simplify the process for students claiming a combined Pell Grant and HOPE Scholarship/Lifetime Education Tax Credit. In your opinion, would it be practical for students and their families to file a request for refund, similar to a Form 1040EZ-T, and claim an education tax credit when they are not required to file an individual income tax return?

Dr. Dynarski's paper describes a simplified process for students claiming a combined credit. To date, GAO has not undertaken any studies of how current Title IV student aid programs or tax preferences could be simplified and, as a result, has not developed any such models or proposals.

As proposed, the combined credit would be subject to income limits, making it necessary for students and families to document their income to receive the benefit. Currently, some students and families are eligible to apply for Title IV student aid even though they are not required to file a tax return. In such cases, Education and schools draw upon information reported by students and families on the FAFSA in administering the Pell Grant and other Title IV student aid programs. In addition, schools may be required to verify income and asset information reported on the FAFSA by students and families even in the absence of a tax return.

Though a number of alternative options could be explored, one would be to continue requiring students and families to complete a FAFSA but providing them the option of checking a box on the FAFSA that provided the Department of Education their permission to calculate their grant eligibility based on their filed tax return and providing their consent for the IRS to disclose that information. Students and/or their parents who did not file a tax return, or who did not wish to have their aid calculated from their tax returns, could instead report information needed to determine aid eligibility on the FAFSA. These steps largely reflect the Dynarski proposal, the difference being that students would be informing Education rather than the IRS of their intent and Education would request information from IRS.

If the assistance to students or families under a program that combined Pell Grants with the tax credits were to be delivered as a tax credit, the Form 1040EZ-T is a possible model, but that form is only concerned with claiming a refund, not with verifying income. Congress would want to consider, among other things, how to balance simplification for program applicants with the need to protect the program's integrity. Although IRS can readily verify some sources of income, such as wages, it has more difficulty verifying income from such sources as self-employment. One approach to better ensuring eligibility for a combined credit might be to require students and families, in addition to filing a form like the 1040EZ-T, to submit documentation concerning their income to school officials, and/or submit statements certifying the sources and amounts of income to school officials, for the purpose of verifying eligibility. After reviewing the documentation, the schools would communicate the results to IRS so that IRS could provide the credit. This process would be unusual for IRS and would need to be thoroughly considered before a judgment could be made as to whether it would be feasible and cost-effective in ensuring high levels of compliance.

Written Testimony of James J. Duderstadt
President Emeritus and University Professor of Science and Engineering
The University of Michigan

to the

U. S. Senate Finance Committee
December 5, 2006

Executive Summary

Thank you, Mr. Chairman.

As you know, earlier this fall Secretary of Education Margaret Spellings received a report from her Commission on the Future of Higher Education conveying a number of troubling concerns. Among the findings included in the report produced by that commission, of which I was a member, were the following:

- While in today's global, knowledge-driven economy a college education is more important than ever, too few Americans have that opportunity.

- There is ample evidence that qualified young people from families of modest means and minority groups are far less likely to attend college than their affluent peers. Today students from the highest income quartile are ten times more likely to attend and graduate from college than those from the lowest quartile.

- The manner in which we finance higher education in America is under increasing strain as institutional costs continue to rise, state support for public universities continues to decline, and the tuition and debt burdens on students soar.

- Our financial aid programs at the federal, state, and institutional level are not only confusing and complex, but they fail to address adequately the needs of low and middle-income students. Key here has been the shift of federal programs over the past several decades from an emphasis on need-based grants to subsidized loans to tax benefits even as the states

and institutions have increasingly emphasized merit- based over need-based financial aid.

While many of the answers to these dilemmas lie within the jurisdiction of other committees of Congress, federal tax policy can and does play a role in the support of higher education. Current tax policies both assist parents in saving and paying for the college education of their children. It also provides strong incentives for donors to contribute to a variety of purposes in higher education.

Yet while most of these tax benefits contribute substantially to our colleges and education, some have drifted rather far from the tax-exempt purposes of education and scholarship. I have written in the past about my concerns about intercollegiate athletics and argued that tax policy is fueling an arms race in stadium construction, coaching salaries, and student exploitation in big time sports such as college football and basketball.

To be sure, federal tax policy helps create a balance between public and private support that has been key to the great diversity and quality of American higher education that is very much envied by the rest of the world. What our tax and student aid policy does not do as well as it should, is to assure that help is directed at the students with greatest financial need so that they can attend college.

The challenge is clear: how do we make sure we provide the right tax structure to go along with broader education policy changes that will ensure access and affordability for higher education for the millions of Americans who need the financial help? It is imperative, both as a matter of social justice and economic competitiveness, that our nation address and remove those factors that

have crated a strong dependence of access and success in higher education upon socioeconomic status while sustaining America's leadership in higher education.

Mr. Chairman, as you begin to look at tax policy broadly in the next Congress, let me suggest that the Committee look at partnering with the Health, Education, Labor and Pensions Committee and other relevant Senate committees in determining the proper role for tax policy to play in making sure more American students attend and succeed in college.

There are others on this panel with more tax policy experience than I who may be able to suggest creative new ways of using our tax system so that more American students can achieve greater skills and abilities through higher education. However I can state that the higher education community would welcome the opportunity to explore those and other ideas with the Committee in the next Congress. Working together, we can begin to tackle these issues that will enable all Americans to benefit from educational opportunity and, in the long run, will determine the very future of America's economic and national security.

The Concerns

Earlier this fall, the Secretary of Education's National Commission on the Future of Higher Education in America (the Spellings Commission) delivered a final report conveying several serious concerns:

- In today's knowledge-driven society, higher education has never been more important. Yet too few Americans prepare for, participate in, and complete higher education.

- The Commission is especially troubled by gaps in college access for low-income Americans and ethnic and racial minorities. Notwithstanding our nation's egalitarian principles, there is ample evidence that qualified young people from families of modest means are far less likely to go to college than their affluent peers with similar qualifications. While over 75% of students from the top economic quartile will graduate from four-year institution, only 8% of the lowest quartile will achieve this goal– almost a factor of ten difference in access and success in higher education.

- Our higher-education financing system is increasingly dysfunctional. State subsidies are declining; tuition is rising; and cost per student is increasing faster than inflation or family income.

- The entire financial aid system – including federal, state, institutional, and private programs – is confusing, complex, inefficient, duplicative, and frequently does not direct aid to students who truly need it. Need-based financial aid is not keeping pace with rising tuition.

- Furthermore, affordability is directly affected by a financing system that provides limited incentives for colleges and universities to take aggressive steps to improve institutional efficiency and productivity. Public concern about rising costs may ultimately contribute to the erosion of public confidence in higher education.

Traditionally, the role of the federal government in higher education has consisted of three elements: i) direct funding of academic institutions to support particular national priorities such as research and development and graduates in key strategic areas such as science, engineering, and medicine; ii) financial aid to

students to enable broader access to higher education, and iii) tax policies designed to stimulate private investment in higher education.

As recent studies such as those by the Council on Competitiveness and National Academies have stressed, federal support of research and graduate education is currently neither adequate nor well aligned with the economic and security needs of a nation facing the flattening world of a global, knowledge-driven economy. However the Senate has recently taken important steps to address these concerns through legislation introduced earlier this year by Senators Alexander, Domenici, and Bingaman.

The Spellings Commission believes that today's federal student financial aid system is simply not adequate to meet the needs of low and middle-income students. The transition over the past several decades from a system focused on need-based grants (such as the Pell Grant program) to subsidized loans has saddled students with heavy debt burdens while unnecessarily subsidizing the commercial lending industry. Furthermore, the further shift of the system toward tax benefits primarily benefits more affluent students and their families rather than those with most need.

Federal tax policy has been extremely important in stimulating support from the private sector for higher education, now estimated to provide more than half of the nation's resources for higher education. This balance between public and private support has been key to the great diversity and quality of American higher education and is very much envied and increasingly emulated by other nations. Similarly the beneficial tax treatment of college savings accounts has encouraged the savings efforts of American families and their ability to afford college. However there remain problems with current tax policy,

resulting both from the susceptibility of the tax code to manipulation by special interests and because of the law of unintended consequences.

An example of the former is the perverse treatment of intercollegiate athletics, in which mandatory fees for athletic events such as luxury skybox leases and licenses to purchase season tickets are treated, in part, as charitable contributions by the current tax code. Ironically these revenue streams are now fueling an arms race in college sports, driving universities to debt-finance massive stadium expansion projects, exploit young student-athletes, and tolerate multimillion dollar coaches salaries, all demanded by big-time college football and basketball programs that have been transformed into commercial entertainment businesses with only marginal relevance to the educational (and, I might add, tax-exempt) mission of the university.

Ironically, the broader higher education tax policies concerning private gifts, endowment income, and tuition and other college expenses may also be having some unintended consequences of a very similar nature. For example, the "edifice complex" that stimulates naming gifts from donors for new capital facilities frequently results in campus monuments such as museums, theaters, or sports facilities only marginally related to the academic mission of the university, yet requiring massive additional investment in both construction and long-term maintenance. Some believe that the recent escalation of the salaries of university presidents into the million-dollar range is been driven in part by their fund-raising role. And while the setting of tuition depends on many factors, including state support for public institutions, some institutions may be inclined to increase tuition in response to the increased capacity of students and parents provided by beneficial tax policies.

Others on today's panel are far more capable of addressing the key policy issues associated with the federal tax treatment of higher education. However as an educator, it seems clear that while America's generous tax policy toward higher education has been a very important–indeed, an essential–element in providing our nation with a higher education enterprise that is the envy of the world, there are also clearly some features of these policies that need attention and fine-tuning from groups such as the Senate Finance Committee.

The Challenge

Education has become a key determinant of one's personal standard of living and quality of life. The breakpoint between those who succeed in college and those who fail is perhaps the most critical decision point in one's life. Yet many recent studies have revealed the degree to which access to higher education in America has become increasingly stratified according to student financial circumstances, thereby undercutting the fundamental principles of equity and social justice. Today even the most academically talented students in the lowest economic quartile are significantly less likely to have access to the benefits of higher education than the least academically qualified students in the top quartile–a situation clearly intolerable for a democratic society.

It is certainly the case that educational costs experienced by institutions and hence the tuition charged to students has been increasing rapidly over the past two decades. Yet here it important to realize that in most colleges and universities, tuition covers only a fraction of the educational costs borne by the institution, e.g., typically about one-third of the costs of public institutions and one-half of those of private institutions. Furthermore, when financial aid is taken into account, many students pay only a fraction of the stated tuition "sticker price"–in fact, many effectively pay no tuition at all. Access to higher education

today remains high for most of our population, both because of the availability of financial aid programs and the great multiplicity and diversity of colleges and universities, ranging from local community colleges and regional four-year institutions to small liberal arts colleges and proprietary (for-profit) institutions to elite private universities and massive public research universities.

Since the tuition or price charged to students represents only a fraction of the actual educational costs, it is determined both by the amount of institutional support from other sources (e.g., state appropriations) and by the marketplace (particularly for private colleges and universities). For example, for public institutions, which enroll roughly 75% of all students, the states provide appropriations from tax revenues that support the rather substantial price discount from the actual costs. But in hard times, when the states cut back their appropriations, then the discount shrinks, and students either have to pay more or universities have to cut programs. Actually, both usually happen. Such has been the case recently, as state support of public colleges and universities has dropped to the lowest level in 25 years on a per student basis. A New York Times editorial put it well: "The United States has moved entire generations into the middle class and beyond by subsidizing public colleges, putting higher education without the reach of many deserving low-income students. The pubic college system is in steep decline, however, because of decades of declining support from states that historically kept educational quality high and tuition low." (NYT, 2004).

In the past, financial aid programs at the federal, state, and institutional level have been primarily designed to address the financial needs of students in an effort to enable access and success in higher education. Yet today we suffer from a patchwork federal, state, and institutional financial aid programs, which have evolved over the years more as a consequence of the political process than

any defined purpose or accountability with respect to impact or efficiency in achieving student access or success in higher education. Today a very significant fraction of public funding for post-secondary education goes primarily to benefit affluent students with modest economic needs, at a time when close to a quarter of Americans are disproportionately and severely deprived of educational opportunity at colleges and universities.

There has been inadequate effort to integrate and restructure the system into a cohesive policy-driven program, despite the obvious benefits and cost savings. While the current system does benefit affluent students, the lending industry, and political objectives, it is both extraordinarily inefficient and ineffective with respect to key objectives such as higher education access, retention, and debt burden. It needs to be replaced with a strategically oriented, results-driven, and greatly simplified program of grants, loans, and tax benefits that demonstrably works to serve clearly articulated goals. As a consequence of both the inadequacy and complexity of existing financial aid programs, many economically disadvantaged students (and parents) no longer see higher education as an option open to them but rather as a privilege for the more affluent.

What To Do?

The Spellings Commission offered several recommendations concerning the access and affordability of higher education:

> Every student in the nation should have the opportunity to pursue postsecondary education. The Commission recommends, therefore, that the United States 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.

To address the escalating cost of a college education and the fiscal realities affecting government's ability to finance higher education in the long run, the Commission recommends that the entire student financial aid system be restructured and incentives put in place to improve the measurement and management of costs institutional productivity. The federal government, states and institutions should significantly increase need-based student aid.

To accomplish this, the present student financial aid system should be replaced with a strategically oriented, results-driven system built on the principles of (i) increased access, or enrollment in college by those students who would not otherwise be likely to attend, including non-traditional students; (ii) increased retention, or graduation by students who might not have been able to complete college due to the cost, (iii) decreased debt burden, and (iv) eliminating structural incentives for tuition inflation.

> Federal grant programs should be consolidated to increase the purchasing power of the Pell Grant. Whatever restructuring of federal financial aid takes place, the Pell Grant will remain the core need-based program. Policymakers and higher education leaders should develop, at the institutional level, new and innovative means to control costs, improve productivity, and increase the supply of higher education. At the same time, the Commission opposes the imposition of price controls.
>
> America must ensure that our citizens have access to high quality and affordable educational, learning, and training opportunities throughout their lives. The Commission recommends the development of a national strategy for lifelong learning that enables all citizens to prepare for and participate in higher education throughout their lives. Lifelong learning should be a right, not a privilege, if the United States is to sustain its economic competitiveness and national security.

A National Agenda for Higher Education in America

More generally, the future of higher education is of immense importance to the United States. The increasing dependence of our nation on advanced education, research, and innovation compel efforts to both sustain and enhance the quality of our colleges and universities. Yet, as this testimony suggests, the traditional structure for financing higher education in America may no longer be viable. Traditionally, this has involved a partnership among states, the federal government, and private citizens (the marketplace). In the past the states have shouldered the lion's share of the costs of public higher education through subsidies, which keep tuition low for students; the federal government has taken on the role of providing need-based aid and loan subsidies. Students and parents (and to a much lesser extent donors) pick up the rest of the tab.

Yet this system has become vulnerable as the states face the increasing Medicaid and retirement obligations of a growing and aging uninsured population, made even more difficult by the state tax-cutting policies during the boom period of the late 1990s. This is likely to worsen as a larger percentage of young people and working adults seek higher education while the tax-paying population ages and health care costs continue to escalate. As Kane and Orzag conclude, "the traditional model of higher education finance in the U.S. with large state subsidies to public higher education and modest means-tested grants and loans from the federal government is becoming increasingly untenable." (Kane, 2003).

One might approach this as an appropriate challenge to the federal government. After all, in some ways it was federal inaction that created the current dilemma, crippling state budgets with unfunded federal mandates such as Medicaid, through federal inaction on national priorities such as universal health care, and shifting philosophies of federal financial aid programs. It is also the federal government's responsibility to invest adequately in providing for economic prosperity and national security, particularly in the new flat world characterized by phenomena such as outsourcing and off-shoring characterizing a hypercompetitive, global, knowledge-driven economy increasingly dependent upon knowledge workers, research, and technological innovation. (Friedman, 2005).

Perhaps it would be more constructive, however, to present this as an opportunity: We have entered an age of knowledge in a global economy, in which educated people, the knowledge they produce, and the innovation and entrepreneurial skills they possess have become the keys to economic prosperity, social-well being, and national security. Moreover, education, knowledge,

innovation, and entrepreneurial skills have also become the primary determinants of one's personal standard of living and quality of life. Democratic societies–and state and federal governments–must accept the responsibility to provide all of their citizens with the educational and training opportunities they need, throughout their lives, whenever, wherever, and however they need it, at high quality and at affordable prices.

Put another way, it is imperative both as a matter of social justice and economic competitiveness that the nation, the states, and our colleges and universities address and remove those factors that have created an alarming dependence today of access and success in higher education upon socioeconomic status. America should aspire to the idea where family income is nearly irrelevant to the ability of a student to attend the college or universities best matched to his or her talents, objectives, and motivation.

Thank you for the opportunity to appear here today. I look forward to discussing these issues with you and the rest of the committee.

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January 22, 2007

United States Senate
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

This letter is intended as a response to the questions from Senator Charles E. Grassley following the meeting of the Senate Committee on Finance on Tuesday, December 5, 2006. I have also provided the responses via e-mail directly to you.

1. In your testimony you mentioned the California State University system as a leader in providing guidance to students about the transition from secondary to higher education. Please discuss the best practices that California State University is using.

In testimony before the Secretary of Education's Commission on the Future of Higher Education in America, Dr. Charles Reed, Chancellor of the California State University System, described a very major and effective commitment of that institution to assist K-12 students in making the transition to college. Our commission viewed this as an exemplar of the types of efforts that colleges and universities might consider to address with respect to the difficulties many students face in attending college. I have quoted below from our final report:

> "One of the best national models of how higher-education and K-12 officials can collaborate to help students is the Early Assessment Program (EAP) developed by Chancellor Charles Reed and administrators at the California State University (CSU) system in partnership with the California Department of Education and the State Board of Education. This statewide assessment is designed to test students' proficiency in mathematics and English and to reduce the likelihood that students will have to take remedial classes once they enter college. The award-winning program embeds a voluntary college-placement exam in the state testing program required of all 11th-grade students, using the CSU's admissions placement standards in math and English. The "early" component of the program–testing in the 11th grade rather than the 12th–provides students an opportunity to make gains in areas of weakness during their senior year."
>
> "Additionally, CSU is raising awareness of college opportunities by reaching future students where they are–in their homes, their churches, and their communities. Partnering with community leaders and the state's K-12 system, administers are targeting low-income and minority students and putting higher education within their reach. For the 54% of CSU's 405,000 students who are racial or ethnic minorities, initiatives such as visits by campus presidents to the largest African-American church in

Los Angeles and partnerships with Latina mothers of elementary school children show the university's commitment to bringing underrepresented populations into higher education. An information "How to Get to College" poster available in English, Spanish, Vietnamese, Korean, and Chinese outlines step-by-step advice on how students and parents can begin getting ready for college as early as the sixth grade. These posters have been distributed to the state's middle and high schools and contain helpful information on the admission process, applying for financial aid, and appropriate courses to take in high school to best prepare students for collegiate-level learning. Finally, the system has a dedicated Web site (http://www.csumentor.edu) to help students and families navigate the college admissions and financial aid application processes."

2. *It is expected that America will need many more science and engineering majors in the next 20 years. How would you suggest universities use endowments to increase America's competitiveness in science, technology, engineering, and mathematics (STEM) fields?*

Several recent reports have stressed the importance of increasing both the number of students in science, technology, engineering, and mathematics (STEM) fields and the amount of federally sponsored research in these fields, particularly in the physical sciences and engineering (e.g., the National Academies *Rising Above the Gathering Storm*, the Council on Competitiveness *National Innovation Initiative*, and the President's *American Competitiveness Initiative*). Both the United States Senate and House of Representatives have responded recently by proposing important legislation to address these challenges, although the Continuing Resolution of FY2006 appropriation levels through the end of FY2007 will have very serious negative consequences for these initiatives.

Endowments represent a very important component of the funding of American higher education because they provide predictable, stable support over the long term for key activities (faculty positions, student scholarships and fellowships, and academic programs). However, since most endowments are created through gifts or bequests from individuals rather than from grants from industry or government, the distribution of income from university endowments is generally quite tightly constrained by the original intent of the donor. Universities have little flexibility to utilize existing endowments to address more immediate priorities such as the current challenges to national economic competitiveness and security presented by inadequate participation in and funding of STEM fields. Since endowment gifts already receive beneficial tax treatment as charitable contributions, it is also difficult to see how federal action could stimulate more donations in this area.

My own views on this subject are consistent with those in the National Academies report: the urgent needs for more students in STEM fields and more research in key physical science and engineering disciplines are best addressed by federal investments in these fields, as proposed in ongoing legislation before Congress.

3. *Please comment on Dr. Dynarski's proposal to combine the Pell Grant and HOPE Scholarship/Lifetime education tax credits into one refundable education tax credit.*

Two of the most significant findings of the Secretary of Education's Commission on the Future of Higher Education in America are:

- There is ample evidence that qualified young people from families of modest means and minority groups are far less likely to attend college than their affluent peers. Today, students from the highest income quartile are ten times more likely to attend and graduate from college than those from the lowest quartile.

- The entire financial aid system – including federal, state, institutional, and private programs – is confusing, complex, inefficient, duplicative, and frequently does not direct aid to students who truly need it. Need-based financial aid is not keeping pace with rising tuition.

Dr. Dynarski's proposal to utilize the tax system as a means to fund and deliver certain aspects of the student loan and grant system could be an important step toward addressing both of these concerns. More specifically, Dr. Dynarski proposes to combine the Pell Grant and HOPE Scholarship/Lifetime programs into one refundable education tax credit. By greatly simplifying the process for assessing eligibility and applying for financial assistance through the current tax system, it could have a very significant impact on those students from less affluent and college-experienced family backgrounds. And by relying on refundable tax credits rather than the current system of tax deductions and grants, it would provide far more opportunity to target federal aid to those students who truly need assistance and address the highly regressive nature of the current tax policy.

However, there are three important points to be kept in mind when considering this proposal: First, the most effective way to consider student financial aid programs is from the point of view of the student since this is where all funding and funding sources come together. The proposal addresses only redirecting existing tax benefits to Pell Grant eligible undergraduate students, while the delivery of other forms of aid such as work-study, other ED grants and loans, VA and other agency programs, tax benefits for graduate students (e.g., teaching assistant/graduate assistant exemptions, graduate fellowships, etc.) are not included, nor are the role of state, private, and institution funds in the overall aid delivery process as they come together to help a particular individual. A more detailed analysis of the Dynarski proposal would consider its interaction with these other programs.

Second, using the IRS return as a far simpler way to determine eligibility for need-based student aid is an effective way to address the complexity that now inhibits many students and parents from applying to programs for which they are qualified. The suggestion that the IRS determine eligibility for other need-based programs including those through the Department of Education also has great merit. While some would argue that the more complex need determination characterizing the existing process (i.e., FAFSA) more accurately targets aid, it was the conclusion of the Spellings' Commission that simplicity at this stage is far more important than the marginal gain in accuracy associated with a process so complex that it is currently excluding many qualified students.

Finally, it should be kept in mind that state and educational institutions also provide significant financial aid to students. The Spellings' Commission concluded that the alarming dependence

of student access and success on economic circumstances was due in part to the shifts in federal financial aid programs over the past several decades (from need-based grants to subsidized loans to tax benefits) that tend to benefit more affluent students at the expense of those with need. Yet the same can also be said of student financial aid programs at the state and institutional level, which have also shifted in recent years from need-based to merit-based criteria that tend to subsidize more affluent students. A major restructuring of federal financial aid programs to place more emphasis on need should be accompanied by a similar challenge to the states and institutions to reconsider their merit-based financial aid programs that have little demonstrable impact on student access.

In summary, Dr. Dynarski's proposal to use the tax system to develop more effective ways to assess student need and deliver financial aid through recoverable tax credits deserves serious consideration by Congress, albeit within the broader context of federal, state, and institutional financial aid efforts.

Thank you for the opportunity to testify before the Senate Committee on Finance last December and to provide this additional input for your consideration.

Sincerely,

James J. Duderstadt
President Emeritus
University Professor of Science and Engineering

JJD/cg

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Oral Testimony of Dr. Susan Dynarski

Associate Professor of Public Policy
John F. Kennedy School of Government, Harvard University
& National Bureau of Economic Research

before the

Committee on Finance

United States Senate

December 5, 2006

Chairman Grassley, Senator Baucus, Members of the Committee, I am honored to have the opportunity to testify before you today.

A college education is a good investment. Over a lifetime, a worker with a bachelor's degree earns, on average, a million dollars more than a less-educated worker.

But college remains out of reach for many. While a third of young white people earn a BA, only 13 percent of African Americans and 8 percent of Hispanics grab that golden ticket. Even among the smartest kids, income is a strong predictor of college attendance. Three-quarters of upper-income kids who do well on tests in high school go on to college, but less than a third of those who grew up in a low-income family.[1]

Designing Effective Education Tax Incentives

I give you these statistics to get us thinking about our goals for the education tax incentives. Whether they have been a success depends on the goals we set for them.

Is our goal to ease the pinch of college costs for middle- and upper income families whose children attend expensive private schools? If so, then the tax incentives do a passable job. I give them a C.

I believe our goals are more ambitious:

- Increase the skills of our workforce.
- Maintain America's competitive edge in the global economy.
- Make college a reality for smart but poor kids who believe it is out of reach.

If *these* are our goals then the current tax incentives are a failure.

Why? The tax incentives can *increase schooling* only if they put money into the hands of kids for whom price is a barrier to college. We need to cut the price of college for those who would not go to college in the absence of the incentive.

- Who are these potential college students? Disproportionately, they are from low-income families. Just half of low-income youth go to college right after high school, compared to 80 percent of their upper-income classmates.[2] They are disproportionately nonwhite or Hispanic.

- Where might these potential college students go to school? The local community college, where tuition and fees average $2,200, or a state university, where costs average $5,500 (College Board, 2005b).

See Figure 1.

This is who we should keep in mind as we design tax incentives for college: a low-income person attending an inexpensive public college. The student admitted to Yale, or Williams, or Dennison, whose family earns $100,000, is going to college with or without a tax incentive, and we should not build our education policy around the prices she faces.

It is not the job of government to make Harvard affordable to the handful who can attend that elite institution each year. It is the job of government to make a solid college education affordable to the millions for whom a BA or AA from a public college is a ticket into the middle class.

The Education Tax Incentives Don't Reach the Right Students

The education tax incentives do just about nothing for low-income students at inexpensive public colleges. Perversely, the tax incentives are focused on upper-income students at the most expensive private colleges.

- Because the education tax credits are not refundable, a family of four must have income above $30,000 to get the maximum credit. Nearly half of families with college students do not get the full credit because their income is too low (Long, 2004b).

- Only students who pay tuition and fees over $10,000 a year get the full Lifetime Learning Credit. This is nearly double the cost of the typical, public four-year college and four times that of the typical community college. Over 80 percent of college students attend schools with tuition and fees under $10,000.[3]

- The expired tuition deduction was most valuable to those in high tax brackets. Deducting $1,000 from taxable income is more valuable for someone in the 33 percent bracket than for someone in a lower bracket. Over half of the benefits of this deduction accrued to households with incomes over $100,000 (Burman, *et al.*, 2005).

The Education Tax Incentives Are Complex and Confusing

The regressivity of the tax incentives is not all that hampers their effectiveness. They are too complicated and confusing to affect schooling decisions. Families can't respond to a price subsidy if they do not understand it.

Again, let's keep our target student firmly in mind. Those on the margin of college entry are disproportionately low-income, nonwhite and Hispanic, with parents who did not graduate college, or perhaps even from high school. For many of these families, English is the second language.

In this context, the education tax incentives are far too complicated to do their job. The IRS publication devoted to explaining them is 82 pages long! The consequences of this complexity extend beyond mere annoyance and frustration. Evidence shows that simple, easily communicated financial aid programs have a robust impact on college entry and completion, and complicated programs don't.[4]

Simplify and Focus the Education Tax Incentives

The goals of reform should be to *focus* the incentives on those who are on the margin of attending college and *simplify* the incentives so that families can understand and respond to them.

1) Create a single, refundable tax credit for tuition, fees, room, and board.

- Merge the Hope and Lifetime Learning Credits into a *single credit*. A single credit would significantly reduce complexity, enabling families to estimate their likely credit well in advance.

- Make the credit *refundable* so families in lower tax brackets are eligible for the maximum benefits.

- Count tuition, fees, room and board as eligible expenses for the purposes of the credit. This matches the definition used for the 529 and Coverdell accounts. It also extends the full credit to the vast majority of students who attend public colleges.

2) Deliver the credit at the time of college enrollment.

- Families need the credit when tuition is due, not a year or more later when taxes are filed. The Department of Education delivers grants and loans to students and their colleges at the time of enrollment, so this can be done.

- IRS can use previous year's income to define eligibility for the education tax credit, so that eligibility is know early.

A Simplified Credit Families Can Count On

The simpler and more streamlined the tax benefits, the easier they are to communicate to families and students.[5] Just as workers are annually sent projections of their Social Security benefits to help them plan for retirement, families could be sent estimates of their tax benefits to help them plan for college. This early, clear information would give students and families confidence they can afford college, and encourage them to work hard in elementary school and high school.

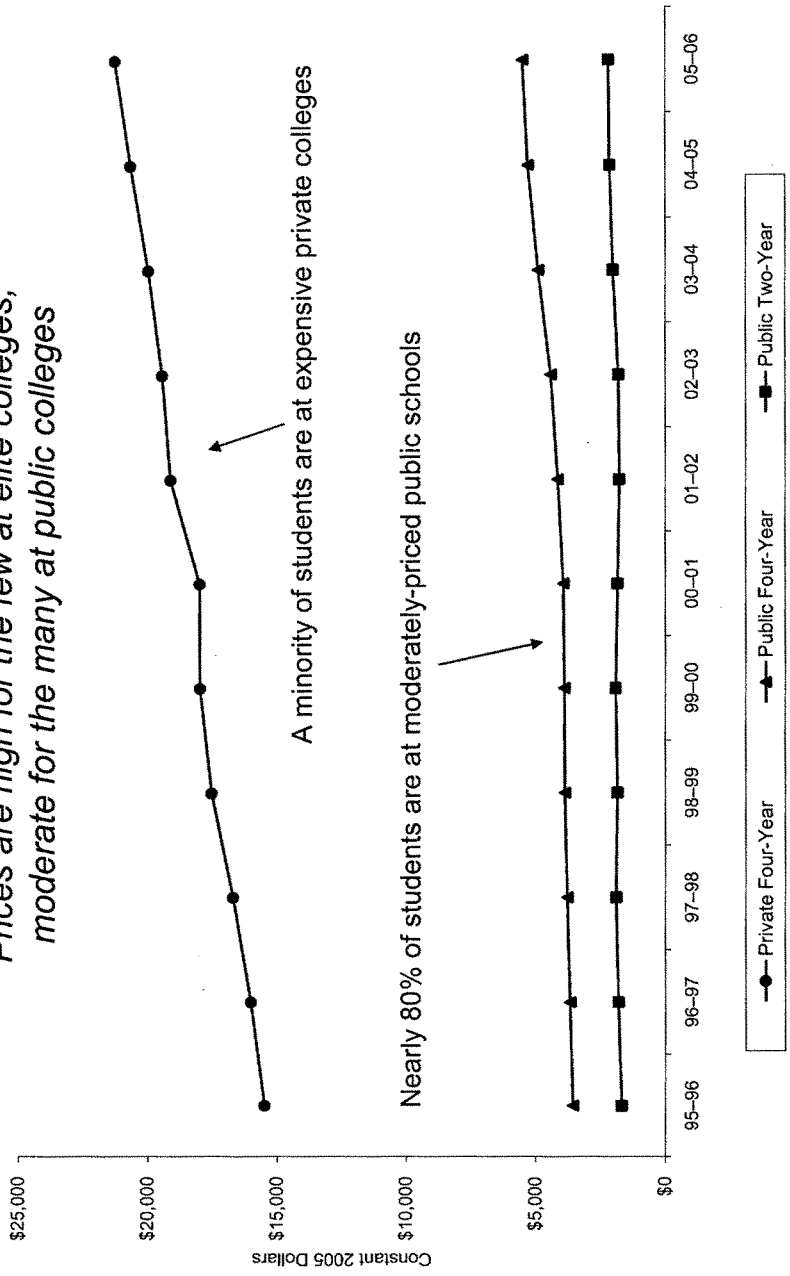
We could even more radically simplify federal benefits for college by consolidating *all* aid for college under the auspices of the IRS. College students and their families now face two parallel, duplicative and unwieldy bureaucracies that provide aid for college: the tax system and the aid system. Moving aid determination into the tax system would substantially simplify the aid process for families.[6]

Conclusion

A well-educated workforce is key to the economic competitiveness of the United States and the well-being of its families. The federal government could do better with its tax incentives for college. Although the education tax benefits provide relief for middle- and high-income families with children in college, they do little to get more people into college. Simplifying and focusing the tax incentives will allow them to serve their goal: opening the doors of college to those who have the ability but not the means to further their education.

Figure 1: Tution & Fees

Prices are high for the few at elite colleges, moderate for the many at public colleges



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Endnotes

[1] BA statistics are tabulations of completed education of 24- and 25-year-olds from 1998, 1999 and 2000 October Current Population Surveys. College attendance statistics by income and test score are from U.S. Department of Education (2005).

[2] College Board, 2005a. Figures are for the top quintile of family income (above $78,000) and bottom two quintiles (below $31,000).

[3] Ninety-five percent of full-time students at public four-year institutions pay less than $9,000, while all two-year public colleges cost less than $10,000. Even if we include private four-year schools, 67 percent of full-time students at four-year institutions pay less than $9,000. See College Board, 2005b.

[4] Dynarski and Scott-Clayton (2006) review the empirical evidence on the types of aid programs that increase education. Long (2004a) shows that the current tax credits do not increase college attendance.

[5] In Georgia, for example, a simple aid program has increase college attendance and completion (Dynarski, 2000, 2004a, 2005). Ninety percent of high school freshmen can name the program and a majority know its eligibility rules, because they are easy to explain and remember.

[6] The federal aid application (the FAFSA) makes the IRS tax forms look svelte. The IRS 1040EZ is a single page with 37 questions. Form 1040A is two pages, with 83 questions. Form 1040 is also two pages, with 118 questions. The FAFSA is *five* pages, with 127 questions. A handful of these questions determine most of the variation in aid. For example, earnings, marital status, family size, and number of family member in college explain 80 percent of the variation in Pell Grants (Dynarski and Scott-Clayton, 2006).

The Feasibility of Delivering Aid for College Through the Tax System

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National Tax Association Annual Conference
November 17, 2006

The federal system for distributing student financial aid rivals the tax code in its complexity. Both have been a source of frustration and a focus of reform efforts for decades, yet the complexity of the student aid system has received comparatively little attention from economists. We describe the complexity of the aid system, and apply lessons from optimal tax theory and behavioral economics to show that complexity is a serious obstacle to both efficiency and equity in the distribution of student aid. We show that complexity disproportionately burdens those with the least ability to pay and undermines redistributive goals. We then use detailed data from federal student aid applications to show that the benefits of complexity, in terms of improved targeting, are small. A radically simplified aid process can reproduce the current distribution of federal Pell Grants using a fraction of the information now collected. Since the essential data elements are already collected by the tax system, we discuss how Pell Grants could be administered through the tax system, eliminating the current burdensome and largely redundant federal student aid application.

Introduction

The complexity of the federal tax code has been the focus of reform efforts for decades, and has received considerable attention in the economic literature. The federal system for distributing student financial aid is similarly convoluted, yet has received relatively little attention from economists. For the typical household, the aid application (the Free Application for Federal Student Aid, known as the FAFSA) is longer and more complicated than the federal tax return. The aid process is also highly uncertain, with definitive information about freshman-year aid not revealed until the spring of the senior year in high school.

The consequences of complexity and uncertainty in aid extend beyond annoyance and frustration. The intent of financial aid is to reduce the cost of college, thereby encouraging college attendance. We argue that complexity disproportionately burdens those on the margin of college entry, thereby blunting the impact of aid on their schooling decisions. Uncertainty about aid similarly blunts its impact on behavior: high school students most sensitive to cost are unlikely to start down the path to college if they do not know it is affordable. For those on the margin of college entry, concrete information about aid simply arrives too late.

Evidence on the behavioral impact of aid supports our argument. While simple, easily communicated aid programs have been shown to have a robust impact on college entry and completion, we have little to no compelling evidence that the traditional forms of student aid (which require a FAFSA) increase schooling for their target populations. Complexity may be the culprit. Simply put, potential college students cannot respond to a price subsidy if they do not know it exists. As both the "sticker price" of college and aid for college have risen sharply, the net price of college has grown increasingly individualized, making it difficult for prospective students to estimate their own schooling costs. Most high school students overestimate the cost

of attendance, but this confusion is of greater consequence for low-income students, who (unlike their upper-income counterparts) are pessimistic about their ability to pay for college (Avery and Kane, 2004).

We use well-known principles of optimal tax policy, as well as more recent insights from behavioral economics, to evaluate the costs of complexity in student financial aid. We demonstrate that provisions intended to precisely target aid produce regressive compliance costs. These costs rightly belong in our cost-benefit calculation when we consider the efficiency and equity of a given targeting provision.[1] The costs of aid complexity fall heavily on low-income, non-white and non-English speaking youth, whose lagging educational levels are repeatedly cited as a justification for financial aid. Though from a rational perspective these compliance costs may seem small relative to the payoff of a college degree, the behavioral literature demonstrates conclusively that even seemingly minor complexities can have profound impacts upon the equity and efficiency of a policy.

We show not only that the *costs* of complexity in student aid are large, but also that the concomitant benefits are quite small. With student-level data from the 2003-04 National Postsecondary Student Aid Survey (NPSAS:04), we show that much of the complexity in the aid system fails to improve the targeting of aid. We find that the aid system imposes large costs in order to measure small differences in ability to pay. Nearly all of the variation in aid is generated by a handful of the more than 70 data items used in the aid formula. Parents' adjusted gross income (or, for tax non-filers, earnings from work), marital status, family size, and the number of family members in college explain over three-quarters of the variation in Pell Grant awards. With only a few more variables, we can replicate 90 percent of the variation in Pell Grants for

[1] Kaplow, 1996 makes this point in the context of the income tax system. The Final Report of the President's Advisory Panel on Federal Tax Reform repeatedly sounds the same theme.

dependent students. Our radically simplified aid calculation throws out 80 percent of the financial items on the aid application. This aid application could fit on a single page.

Since the IRS 1040EZ already collects the key pieces of data that determine aid eligibility (adjusted gross income and dependency status), a feasible option would be to eliminate the FAFSA completely and run student aid entirely through the tax system. The need-based Pell Grant program could be combined with the current jumble of federal tax credits for higher education to create a single, easy-to-understand grant program. Families could apply for this grant by checking off a box on their federal tax form. We describe how funds could be delivered when they are needed, at the time of college enrollment.[2] This approach would cut back on paperwork and enable families to learn about their aid eligibility years in advance. We describe how such a system might work, as well as potential obstacles it might face.

A simple aid program is an easily-communicated aid program. Simplification would allow personalized information about aid to be communicated to families *early*. Just as workers are annually sent projections of their Social Security benefits to help them plan for retirement, families could be sent estimates of their aid eligibility to help them plan for college. Under the current system, students do not get accurate information about student aid until late spring of senior year in high school. Early information about federal help for paying for college is critical for low-income families. If the goal of aid is to encourage college attendance, then the end of the final year of high school is simply too late for information about subsidies to arrive.

Our paper is emphatically not an argument against progressivity in aid. An aid system, like a tax system, can be both simple and progressive, and we conclude that reducing complexity in aid would be both efficient and equitable. The current aid system creates formidable barriers

[2] We focus this paper on grants, to keep the analytics tractable and the discussion uncluttered. The concepts of the paper apply equally to eligibility for government-subsidized student loans. Subsidized loan eligibility, like grant eligibility, can be predicted with a handful of variables instead of the dozens in the FAFSA.

to college. A key lesson of our research is that we can dismantle these barriers if we are willing to tolerate minor imperfections in measuring ability to pay. This, we believe, is a worthwhile tradeoff. Reducing unnecessary complexity will allow aid to serve its intended goal: opening the doors of college to those who have the ability but not the means to further their education.

Financial Aid Overview

Two agencies provide subsidies to college students and their families: the Department of Education and the Internal Revenue Service:

The Department of Education (Pell Grants)

The Department of Education administers the Pell Grant program, which delivered $13 billion to five million students in the 2004-05 academic year (expenditure data are from College Board, 2005). These grants averaged $2,500 per recipient, with a maximum value of $4,050. Pell Grants are highly progressive, flowing almost exclusively to families with incomes below $40,000 (Stedman, 2003).

The Free Application for Federal Student Aid (FAFSA) is required for the Pell Grant. The FAFSA collects basic demographics (e.g., name, social security number, citizenship, date of birth, etc.) as well as detailed information about the student's and parents' income, assets, and expenditures. See Appendix for a copy of the 2006-07 FAFSA. Families cannot obtain an estimate of their federal aid eligibility without submitting a FAFSA.[3] Prospective freshmen cannot file a FAFSA until January of their senior year of high school. The aid determination process is summarized in Figure 1.

[3] Some websites offer EFC calculators, which require the same data as the FAFSA. An enterprising student or parent could therefore calculate the EFC without completing a FAFSA. We would hazard that, for a family that is able to do this sort of sleuthing, federal financial aid is not a determinative factor in the college entry decision.

Once the FAFSA is submitted, the U.S. Department of Education computes the expected family contribution (EFC), an estimate of how much the family can pay out of pocket for college. "Need" is defined as the difference between the cost of attendance (e.g., tuition, fees, books, and living expenses) and this family contribution. The EFC, but not any estimate of aid eligibility, is mailed to the applicant as well as the colleges to which she has applied (U.S. Department of Education, 2005d). Using the EFC, colleges personalize a package of grants and loans for each student, which they then mail out in the form of award letters, typically in March and April. Only upon receiving these award letters do students know how much college will cost for the upcoming year.

In Table 1 we compare the FAFSA to the IRS 1040, 1040A and 1040EZ income tax forms. The FAFSA, at five pages and 127 questions, is lengthier than Form1040EZ (one page, with 37 questions) and Form 1040A (two pages, with 83 questions). It is comparable to Form 1040 (two pages, with 118 questions). With this comparison we do not mean to suggest that the U.S. tax system is a paradigm of simplicity. The statistics in Table 1 understate the complexity faced by taxpayers who must fill out additional worksheets and schedules in order to complete the questions listed on the 1040. But for the families targeted by need-based aid, complexity in the aid application rivals the complexity they experience in the income tax system. Most families eligible for the Pell file the shorter 1040A or 1040EZ; 86 percent of filing households with income below $50,000 (and two-thirds of all households) use these simplified IRS forms. The contrast between Form 1040EZ and the FAFSA is especially striking. With a third of the FAFSA's questions and a fifth of its pages, the IRS captures the information needed to determine tax liability for the very population targeted by need-based aid.

Why is the FAFSA so long? In part, because the aid formula applies different "tax rates" to the student's and parents' resources, and so asks separate questions about each.[4] But, as Table 1 shows, the FAFSA demands more detailed measures of financial resources than do the income tax forms. Thirty-three FAFSA questions probe for sources of income not shown on the W-2, compared to two on the 1040EZ, 12 on the 1040A and 19 on the 1040. Further, while none of the tax forms ask about assets, the FAFSA has six questions on this topic.

The IRS estimates it takes 16 hours to complete a 1040. The 1040A and 1040EZ are estimated to require 13 and eight hours, respectively. These are likely conservative estimates: Blumenthal and Slemrod (1992) conclude that the time required for tax compliance averages 27 hours per filing household, and is longer for low- and high-income households. The U.S. Department of Education improbably estimates that it takes one hour to complete the FAFSA.

An obvious point, but one worth stating in this context, is that when a taxpayer has completed her 1040, she knows how much tax she owes. To this end, twenty-one of the questions on the 1040 are calculations or look-ups from tax tables. Completing the FAFSA yields no comparable information about aid eligibility. We will return to this point later in the paper. For now, we simply highlight the fact that, upon completing the FAFSA, the aid applicant is no more informed about her financial aid eligibility than she was when she began.

The Internal Revenue Service (Tax Credits and Deductions)

The Internal Revenue Service administers the tax incentives for higher education. These provisions include the Hope tax credit, the Lifetime Learning tax credit, and the deduction for

[4] The highest tax rate on parental assets is about six percent for each year of college, while the student's assets can be taxed at 35 percent (this rate will fall to 20 percent as of the 2007-2008 academic year). The marginal tax rate on parental income ranges from 22 to 47 percent. For student earnings the tax rate is zero below an earnings protection allowance and 50 percent above that allowance. See Dynarski (2004b) for a discussion of how the aid tax on assets varies by ownership and asset type.

college tuition and fees.[5] The Hope and Lifetime Learning credits are worth up to $1,500 and $2,000, respectively, with eligibility depending on college costs, year in college, and tax liability. Neither credit is refundable, which means that those who are too poor to owe taxes do not get a credit. The deduction allows parents to deduct up to $4,000 in tuition costs from their taxable income; the value of this deduction depends on the household's marginal tax rate, with the highest values accruing to those in the upper brackets. The value to taxpayers in 2005 of these provisions was $8 billion.[6]

Application for the tax credits occurs when a family files its tax return. A family can apply for a credit only for schooling expenses incurred the preceding tax year. This means that these subsidies arrive up to sixteen months after tuition has been paid. Consider a student who pays her tuition for spring semester of academic year 2005-2006 in January of 2006, a typical schedule. Her family will file for its Hope or Lifetime Learning credit sixteen months later, in April 2007. The value of the credit is known only after a family knows its tax liability for 2006, after all income has been earned. The value of the credits is therefore highly uncertain, and is not even revealed until well after the student has gone to school.

Both the Pell Grant program and the education tax benefit programs are beset by complexity. In the next section, we present our argument for why complexity matters. We focus on complexity in the Pell Grant application process, since this is the largest federal education benefit and because complexity in taxation systems has received much more attention in the literature. In the final section, we will describe how this complexity could be substantially reduced.

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[5] Other tax incentives for education are the tax-preferred savings plans known as the Coverdell Education Savings Account and 529 Savings Plans (see Dynarski, 2003a and 2003b) and the student loan interest deduction.
[6] Joint Committee on Taxation, 2006. *Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010*, p. 37. Washington: U.S. Government Printing Office (http://www.house.gov/jct/s-2-06.pdf).

Insights from Optimal Tax Theory

Complexity in the tax system arises from attempts to precisely measure taxpayers' ability to pay.[7] Analogously, complexity in the need-based aid system arises from attempts to precisely measure ability to pay for college. As has been highlighted in the tax literature (Kaplow, 1990 and 1996), measuring income more accurately produces costs to society that are frequently ignored by policy-makers and analysts. Kaplow (1996) offers the following illustrative example. Consider two people with "true" income of $40,000. Unless a deduction is allowed (say, for unusual health expenses) one person will have a reported income of $45,000. Creating the deduction will allow for more accurate measurement of income, so the added complexity has a benefit: it prevents us from reducing one person's income below its socially optimal level. But there are also costs to this new provision:

1) *compliance costs* for taxpayers, such as time spent learning about the rules and formulas, record-keeping, and completing forms.
2) *administrative costs* for the government (or schools), which are ultimately paid by taxpayers in the form of higher taxes or reduced services.
3) *efficiency loss* as taxpayers alter their behavior so as to shield income under the deduction.

These costs of complexity should be weighed against its benefits in determining whether a given aspect of the tax code (or aid system) enhances social welfare. The needs of low-income students clearly weigh heavily in our calculation of social welfare, or else we would not have a progressive grant system then targets them for subsidy. The needs of low-income students should then also weigh heavily when we add up the *costs* they must incur in order to obtain the subsidy.

[7] Complexity can also arise when policymakers "deviate from tax principles in order to subsidize certain activities and groups (Kaplow, 1996)." For example, the mortgage interest deduction and 401(k) are tax provisions intended to encourage homeownership and retirement saving, respectively.

In the language of economics, compliance costs that fall on a group with high weight in our social welfare function will disproportionately reduce social welfare, just as transfer to that group will increase social welfare. A key lesson is that any policy intended to redistribute income should be carefully crafted so that it does not create costs that outweigh its benefits.

The case of the Earned Income Tax Credit illustrates how in a progressive program compliance costs can have a regressive impact. Despite the large value of this credit, non-participation in the program is substantial and a perennial source of concern (Greenstein, 2005). Applying for the EITC may be quite daunting for the target population (Berube et al., 2002). Recently, H&R Block and other tax preparers have found a market niche filing tax returns for low-income families eligible for the credit, and as a result seventy-five percent of EITC recipients now use a tax preparer (President's Advisory Panel on Federal Tax Reform, 2005). Both parties benefit – the taxpayer gets a credit, and tax preparers take a cut in the form of a $100 fee and (annualized) interest rates exceeding 200 percent charged on "refund loans" (Berube et al., 2002). A full accounting of the costs and benefits of the EITC would include these as compliance costs. Compliance costs clearly reduce the progressivity of the EITC, since part of the EITC leaks to tax preparers. A simplification that at first blush appears to reduce the progressivity of the EITC may prove progressive were it to reduce this leakage. We argue that the same holds in the aid system: a simplification that appears distributionally neutral may prove progressive in its incidence.

Consider the case in which we seek to measure ability to pay for college more accurately by asking questions about untaxed income, such as welfare benefits and disability benefits. Such questions account for much of the complexity in the aid application. These questions are asked in order to withhold aid from families that can pay more out of pocket than implied by a less

precise measure of income. The benefit of this added complexity is that money can be now channeled toward more optimal uses: more "needy" aid recipients, other government programs, or lower tax rates. If the source of income is quite rare, then only a small amount of money will be freed up in this way, yet every aid applicant must still read through the additional questions and instructions in order to determine whether any of her income falls into the relevant category. In this case, compliance costs could easily outweigh the freed-up funds produced by the additional questions.

In some cases, costs can enhance efficiency *because* they fall on those seeking the transfer (Akerlof, 1978; Nichols and Zeckhauser, 1982). For example, requiring people to wait in long lines in order to receive welfare benefits may be efficient if those with the least need have the highest opportunity cost of their time. In this case, compliance costs help to screen out those who are not the intended targets of the transfer. But the inverse also holds: if compliance costs fall most heavily on the intended targets of the transfer, redistribution is less efficient. In the extreme, costs may drive the targeted group out of the program.[8] As we discuss shortly, compliance costs for student aid are likely highest for the poorest families, and may deflect some their intended target (low-income families) from applying.

Efficiency Loss and Administrative Costs Induced by Complexity in Aid

Compliance costs are the focus of our analysis, so we will only briefly address the efficiency and administrative costs of complexity.

At the core of public finance is the principle that an efficient tax system taxes the broadest base at the lowest rate. Variation in tax rates (induced, for example, by excluding some

[8] Indeed, there is evidence that complexity in the provision of social benefits reduces the take-up of transfers (Bitler, Currie, and Scholz, 2003; Brien and Swann, 1999; see literature review by Currie, 2004).

goods from taxation) creates incentives and opportunities for gaming the system, such as shifting assets into untaxed financial vehicles. This has equity consequences, since these strategies are implemented only by those who have the resources to play the game – e.g., those who can hire advisers to find clever shelters for their income and assets. Tellingly, an industry of highly-paid aid advisers has emerged to guide families through the aid system.

The administrative costs of student aid accrue to both the government and colleges. The government's administrative costs (excluding the administration of federal direct student loans) are not strikingly high in comparison with the billions of dollars of aid distributed: an annual report from the Office for Student Financial Assistance estimated an operational/overhead cost of about $19 per unduplicated grant/loan aid recipient in 2000, which would imply administrative costs of approximately $179 million in 2004 (U.S. Dept. of Education, 2002c).[9]

The lion's share of administrative costs are borne by the colleges themselves, who are responsible for answering students' questions, verifying student information, and packaging and disbursing federal student aid. Financial aid administrators and support staff paid by the colleges are responsible for these tasks. To pay colleges' administrative costs, the Department of Education allocated to schools administrative allowances of $83.4 million in 2005.[10] However, schools almost certainly incur costs far in excess of this allowance. Estimates of the annual cost of audits alone range from $132 million (US Office of the Inspector General) to $432 million (Advisory Committee on Student Financial Assistance, 2005).[11] The lower bound of these estimates exceeds the entire administrative allowance for 2005. Note that since the colleges'

[9] In 2004 there were 9.4 million unduplicated aid recipients (U.S. Dept. of Education, 2005e, http://www.ed.gov/about/overview/budget/budget06/summary/edlite-section2d.html#tables).
[10] Calculated from data at http://www.ed.gov/about/overview/budget/budget06/summary/edlite-section2d.html#tables. Schools can allocate to administrative costs five percent of their funds for Supplemental Educational Opportunity Grants, work-study, and Perkins Loans; these aid sources totaled $3.3 billion in 2005. Schools are also allocated five dollars per Pell Grant recipient, of which there were 5.33 million in 2005.
[11] The OIG and ACSFA estimates are contained (respectively) in US Department of Education (2002a) and Advisory Committee on Student Financial Assistance (2005).

costs are not a line item in the federal budget, they are likely to be overlooked when policymakers consider the costs and benefits of complexity in the aid process.

Compliance Costs Induced by Complexity in Aid

Compliance costs, which fall on applicants, are the focus of our analysis. Compliance costs include the time and resources required to learn about the system and its rules, collect all of the required documents, and fill out the form. Though low-income families likely have a relatively low opportunity cost of time, the *length* of time required to learn about and comply with any given provision of the aid process is higher for low-income families. In addition, some families face barriers (such as language) that additional time does little to diminish.

Low-income families have little prior experience with the aid system, since the parents are unlikely to have gone to college and applied for aid themselves. Half of low-income high school seniors do not have a parent who ever attended college.[12] Their classmates and siblings are also relatively unlikely to attend college. This lack of college-going peers and relatives blocks a channel that could communicate information about need-based aid to the target population. Liebman (1998) concludes that peers play a crucial role in informally transmitting information about the EITC, a complicated tax program that encourages work by partially matching the wages of low-income parents.[13] A non-working, low-income mother may observe the improving financial position of neighbors who have entered the workforce and (unknown to her) received the EITC. Even if she does not understand the structure of the EITC's incentives, she may respond *as if she did,* and enter the workforce. Since 80 percent of families with incomes between 100 and 150 percent of the poverty line receive the EITC, this is a plausible scenario; a poor person is likely to know someone benefiting from the EITC. By contrast, just 34% of low-income black youth and 33% of low-income Hispanics have even attempted college, severely limiting the informal transmission of information about college costs within these populations.[14]

[12] Authors' calculations using data from the National Education Longitudinal Survey of 1988 (U.S. Department of Education, 2002b), comparing families with income below $25,000 to those with income above $50,000.
[13] Bertrand, Luttmer, and Mullainathan (2000) and Duflo and Saez (2003) show that social networks have a strong influence on welfare participation and saving behavior, respectively.
[14] Authors' calculations using the National Longitudinal Survey of Youth, 1997. We measure college entry by 1999 for those who were 16 to 17 years old in 1997, which is when family income is measured. Low income is defined as having family income below $20,000 in 1997.

People can learn about complicated programs not only from observing peers' transactions but also through their own repeated transactions. Liebman and Zeckhauser (2004) conclude that when faced with complicated price schedules (such as those for cell phone contracts) people may respond not to marginal prices but "average" prices gleaned from past experience. In the case of college, interactions with the aid system for a given family are infrequent, so opportunities for backing out average prices are rare.

Language is another barrier, with 13 percent of low-income students primarily speaking a language other than English at home, double the rate of families with above-median incomes.[15] Even the basic step of locating financial records is an obstacle for poor students, due to higher mobility rates and family dysfunctions such as divorce and separation of children from parents. Low-income families are substantially less likely to have access to the internet at home, a handicap in a system that relies heavily upon the web for the dissemination of information and is moving towards an exclusively on-line application system. In 2003, over two-thirds of children from families with incomes below $25,000 had no access to the internet at home, compared to 12 percent of families with incomes above $50,000.[16] Families may be reluctant to bring financial documents to a school or a library in order to enter these data into a public computer.

In sum, poorer families are likely to face greater costs of learning about the aid system, collecting the required documents, and completing the aid form. The costs of aid complexity are regressive, falling heavily on low-income, non-white and non-English speaking youth whose lagging educational levels are repeatedly cited as a justification for need-based financial aid. These costs rightly belong in our cost-benefit calculation when we consider the efficiency and

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[15] Ibid.

[16] Source: Authors' computations using published tables from the 2003 Computer and Internet Supplement to the Current Population Survey, http://www.census.gov/prod/2005pubs/p23-208.pdf.

equity of a given targeting provision.[17] Though from a rational perspective these compliance costs may seem small relative to the payoff of a college degree, the behavioral literature demonstrates conclusively that even seemingly minor complexities can have profound impacts upon the equity and efficiency of a policy.

Insights from Behavioral Economics

We have made the case that the cost of compliance in the aid system is substantial, especially for low-income families, and that this complexity blunts the impact of the subsidies on schooling decisions. However, a valid rejoinder to this argument is that the financial returns to a college education dwarf any reasonable estimate of the costs of applying for aid. Thus, if people behave rationally, anyone who is deterred from going to college by such relatively small compliance costs must have an unusually low expected return to college.

A key insight of behavioral economics is that people systematically do not behave rationally, even in matters where we might most expect calculating rationality. Indeed, individuals deviate from rationality in highly predictable ways that tend to shock only economists. In this section, we provide a brief overview of insights that behavioral economics can offer in the realm of student aid and college attendance.

Time Inconsistency

People are poor at committing to behaviors that require present sacrifice in pursuit of future returns (O'Donoghue and Rabin, 1999). This characterizes a broad range of behaviors,

[17] If this line of argument sounds eerily familiar, it is because it was made in the pages of this journal (Kaplow, 1996) in the context of the income tax system. The Final Report of the President's Advisory Panel on Federal Tax Reform repeatedly sounds the same theme.

including saving for retirement, exercise, and schooling. People may plan to get up early to exercise, but hit the snooze button when the alarm goes off. They may plan to save for retirement, but never enroll in their employer's 401(k). They may plan to go to college, but fail to fill out their FAFSA or register for the SAT. While they may firmly believe that saving or exercise or college is the right choice, when the time comes to make the required sacrifice, commitment falters. These are examples of what economists refer to as time-inconsistent preferences.

By its nature, college is an investment: upfront sacrifices are required (tuition, forgone earnings, studying) in order to obtain back-loaded benefits (better job, higher earnings, higher social status). Applying for aid is part of the cost of college, requiring a current sacrifice in order to yield a future return. Given that adults are guilty of procrastination and avoidance in quite high-stakes investments (Thaler, 1994), we would not expect all teenagers who would benefit from aid to apply.

Loss Aversion

Nobel Laureates Daniel Kahneman and Amos Tversky (2000) show that people are loss averse: they avoid worthwhile bets because "losses weigh more heavily than gains." That is, a dollar lost decreases utility more than a dollar gained increases it. In lab experiments and in real-world settings, people "underweight outcomes that are merely probable in comparison with outcomes that are obtained with certainty" (Kahneman and Tversky, 2000). When it is the gains that are probable and the losses that are certain, this will lead to risk aversion and avoidance of even "good bets." Certain costs and probable gains characterize college. Students must apply for aid, give up earnings, pay tuition, and study. These are certain outlays. By contrast, students

cannot know with certainty how well their investment will pay off. While, on average, college is a good bet, there is enormous variance in the earnings of college graduates. For some, college will not pay off, and this possibility may weigh heavily in schooling decisions due to loss aversion.

Default Behavior

Economists and psychologists have found that individuals' decisions are strongly influenced by their "default" course of action (Samuelson and Zeckhauser, 1988). An influential study examined retirement saving at a large financial firm (Madrian and Shea, 2001). At this firm, 401(k) participation required that new employees check a box on a form; the consequence of *not* checking that box was *not* participating in the 401(k). That is, the default option was non-participation. Despite the low transaction costs of enrollment and strong financial incentives (tax advantages plus an employer match of savings), participation rates were low. The company made a minor change: *non*-participation now required that the new employee check a box on a form and so participation was the default option. This small change in program design had a profound effect on behavior, increasing participation by 50 percentage points.

Seemingly minor obstacles put low-income youth off the path to college, much as adults are put off the path to saving by bureaucratic details. A study of high school seniors in Boston found that few low-income youth "decide" against college. Rather, they miss a key deadline, or incorrectly fill out a form, or fail to take a required class, and thereby fall off the path to college (Avery and Kane, 2004). For upper-income teenagers, the affirmative actions of their parents and schools establish college entry as the "default" path. Their high schools guide them through the multiple steps and deadlines of the college and financial aid process. Schools provide SAT

preparation on site, schedule exams for students, organize the writing of recommendations, and remind students repeatedly about relevant deadlines. Informal guidance and support is also provided by their college-educated relatives and neighbors, who act as *de facto* guidance counselors.

By contrast, due to their comparatively weak institutional and social supports, the default option for low-income students is to not go to college. Navigating the maze of college and aid application requires both formal and informal support. Lower-income schools receive fewer visits from college representatives and have fewer guidance counselors per student.[18] Parents and siblings are not likely have gone to college, and so cannot compensate for this lack of institutional support.

Identity Salience

A program may discourage participation through the self-identification it triggers in people. The food stamp application process, for example, "cues negative identities and can induce guilt and alienation," thereby discouraging take-up (Bertrand, Mullainathan, and Shafir, 2004). The FAFSA is rich with negative cues relating to poverty and criminal activity. The FAFSA asks "Have you ever been convicted of possessing or selling illegal drugs? If you have, answer 'Yes,' complete and submit this application, and we will send you a worksheet in the mail for you to determine if your conviction affects your eligibility for aid." The final step in submitting a FAFSA is the signing of a statement which concludes with "If you purposely give false or misleading information, you may be fined $20,000, sent to prison, or both." The full signing statement is nearly five times longer than that on IRS Form 1040. Multiple questions

[18] Data on college representatives comes from NELS:88-2000, 1992 school survey. Counselors comes from *The Condition of Education 2000*, Indicator 28, see also Indicator 27.

about welfare payments repeatedly remind low-income students about their poverty, while open-ended questions that require the calculation of net worth or income (applicants are asked about "money received, or paid on your behalf (e.g. bills), not reported elsewhere on this form") could generate anxiety among even middle-class applicants.

Evidence of the Impact of Student Aid

There is plenty of evidence that student financial aid *can* have a large impact on behavior. Data from the National Longitudinal Survey of Youth show that the Social Security Student Benefit program substantially increased college enrollment rates among eligible youth (Dynarski, 2003). Under this program, children of Social Security beneficiaries continued to get their benefits past their usual expiration at age 18, as long as they enrolled in college. The compliance costs were minimal. The Social Security Administration sent a letter to child beneficiaries shortly before their 18th birthday, asking if they intended to go to college. If they replied in the affirmative, checks continued to arrive. Renewal required confirmation of enrollment from the college registrar. The program provided early information, in that beneficiary families were familiar with the provision. Families knew the exact amount of the benefit, since they were already receiving it.

Another simple program, Georgia's HOPE Scholarship, requires only that high school students maintain a 3.0 GPA in high school in order to have their tuition and fees paid at any public college in Georgia. High schools proactively send transcript data to the state in order to identify scholarship winners. For most students, the HOPE application consists of a half-page of basic biographical information. High school students are knowledgeable about the program. More than seventy percent of Georgia high-school freshmen surveyed were able to name the

program without prompting. Fifty-nine percent, when asked to list some requirements of HOPE, volunteered that a high school GPA of 3.0 is necessary (Henry, et al, 1998). The program substantially increased college entry in Georgia (Dynarski, 2000), as well as the share of young people completing a college degree (Dynarski, 2005). Research on similar state programs has produced similar findings (Kane, 2003; Dynarski, 2004a and 2005).

By contrast, there is little to no persuasive evidence that the Pell grant program affects college enrollment decisions of young people.[19] A plausible explanation is that the application process screens out students teetering on the margin of college entry. A prospective student who is able to deduce her aid eligibility, apply to college without knowing what resources will be available to pay for it, and successfully complete the FAFSA almost by definition reveals herself as firmly committed to attending college. Similarly, evidence (Long, 2004) indicates that the education tax credits have no impact on college attendance rates.

Simplifying the Aid System

We have argued that the costs of complexity in the federal student aid process are substantial. But don't we need this complexity to target aid at those who need it most? If the FAFSA asks just ten questions instead of 120, don't we risk giving aid to the wrong people? This section examines how much targeting we stand to lose by drastically simplifying the aid process. The short answer is "very little." A handful of the questions on the FAFSA determine eligibility

[19] An early study by Hansen (1983) examined enrollment rates before and after implementation of the Pell Grant program. Hansen found that while enrollment rates of all income groups increased during the 1970s, enrollment among low-income students did not increase disproportionately. Kane (1995) utilizes more years of data and limits the sample to women, whose enrollment patterns were less disrupted by the Vietnam War but is also unable to find an effect. Seftor and Turner (2002) find a small effect of Pell Grants on college enrollment for older, independent students. Bettinger (2004) finds suggestive evidence that Pell Grant size affects college completion, but notes his results are very sensitive.

for federal aid. The dozens of other questions could be jettisoned while still maintaining a progressive program *and* without spending more on aid than we do now.

Our key conclusion is that income and a handful of other pieces of information tell us what we need to know in order to determine a family's ability to pay for college. If we know that a family of four earns $20,000 a year, we also know the family is eligible for the Pell Grant. We don't need to learn about the family's tax deductions, Food Stamps, medical expenses and welfare benefits to reach this conclusion – yet the FAFSA asks all of these questions. Similarly, if a family of three earns $100,000 a year, then we know it won't be getting a Pell Grant. We don't need to know about the family's 401(k) investments, financial assets, and business income to reach this conclusion.

We are interested in the "low-hanging fruit" – that is, identifying complexity that creates barriers to applicants while providing little payback in the form of improved targeting. We use data on student aid applicants and recipients (the nationally representative 2003-04 National Postsecondary Student Aid Survey) to see how far we can go in simplifying aid while still maintaining its progressive nature. Our sample consists of 24,253 dependent and independent undergraduates who attended college full-time in 2003-04 and who applied for federal aid (see Appendix for details).

We first use the NPSAS data to replicate the current distribution of grants.[20] To measure the influence of the various data elements on aid, we sequentially exclude data items from the aid formula and recalculate aid, and then compare the new estimates to their baseline values.[21,22]

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[20] We calculate aid using the federal financial aid formula (described in Appendix) and compare these calculated aid amounts with their true values, which are given in the NPSAS. Our calculations of Pell Grants are extremely close to their true values. Regressing the actual against the predicted values yields an R^2 of 0.997.

[21] We are not the first to estimate the predictive power of individual FAFSA items on student aid. Kane (1995) notes that most of the variation in Pell Grants can be explained using just a few variables. Stoll and Stedman (2004) use student-level FAFSA data (from the 1999-2000 NPSAS) to simulate the effect on the EFC of excluding items from the aid calculation.

We use several methods to measure how well the simplified formulas do in replicating the existing distribution of aid. First, we calculate the share of people for whom the difference between the true and simulated aid is less than $100 or $500. Second, we calculate the correlation between the aid amounts that students currently receive and the amounts they would receive with the simplified formula. Third, we plot how aid changes for different groups of students, showing how gains and losses vary with family income.

Approach A: Distribute Aid Using Income, Assets & Family Structure

We start with by throwing out *all* of the data used in the aid calculation except for adjusted gross income of the parents or independent students and their spouses (or, for non-filers, earnings), dependent students' earnings, parents' and students' assets, parents' and students' marital status, family size and number of family members in college. This approach discards parents' and student's taxes paid, the types of income tax forms filed and the required "worksheets" (reproduced in Appendix) that elicit information about transfer income (such as the EITC, welfare, and Social Security) and other income (child support). These worksheets account for 45 of the 70 financial questions used in the calculation of aid.

Using only the items in Simulation A would cut the number of financial questions on the FAFSA by more than 80 percent. Pell Grant eligibility changes by less than $100 for 76 percent of aid applicants. The correlation between the existing Pell and the simulated Pell is 0.95 (with a correlation of 1.0 indicating a perfect correspondence). This approach has a negligible impact on

[22]Mechanically, this is achieved by setting the value of the excluded items to zero. We have also tested setting excluded values to their means or medians, with substantively similar results. For state of residence and elder parent's age, which are excluded from some simulations, a value of zero is not meaningful, so we assign to all applicants the default values that the aid formula imputes when these items are missing from a FAFSA.

program costs, with the average Pell dropping by $14. All of this decrease occurs for families with income over $30,000; families with lower incomes actually see an increase in their grants (see Figure 2).

Why are we able to throw out so much information about applicants, with so little consequence for their Pell eligibility? First, many of the data items on the FAFSA are relevant to very few families (e.g., living stipends for the military and clergy, foreign income); that is, while these items affect eligibility, they are non-zero for a small number of people.

Second, some of the items are common, but only at the top or bottom of the income distribution (e.g., IRA rollovers and welfare benefits). Those at the top or bottom of the income distribution qualify for no aid or the maximum of aid solely on the basis of their income, rendering additional information about their financial situation irrelevant. If we know that a family of four earns $20,000 a year, we also know the family is eligible for the Pell Grant. We don't need to learn about the family's tax deductions, Food Stamps, medical expenses and welfare benefits to reach this conclusion – yet the FAFSA asks all of these questions. Similarly, if a family of three earns $100,000 a year, then we know it won't be getting a Pell Grant. We don't need to know about the family's 401(k) investments, financial assets, and business income to reach this conclusion. The bottom line is that the dozens of questions we eliminate in our simulation don't currently affect eligibility, despite the substantial compliance costs they create.

Approach B: Distribute Aid Using Income and Family Structure, Dropping Assets

We next discard parents' and student's assets from the calculation of aid. The "taxation" of assets by the aid formula has been roundly criticized by economists. Edlin (1993) and others

have argued that the taxation of assets by the aid formula creates horizontal inequities: identical families with identical lifetime earnings can be treated very differently by the aid system, with aid reduced for the family that has sacrificed consumption in order to save for college.[23]

In practical terms, assets have little impact on the calculation of federal aid. When we drop all assets from the aid formula, only 25 percent of applicants experience any change in their Pell Grant, and only 13 percent experience a change of $500 or more. Excluding assets increases the average Pell at low levels of income (Figure 3). Total Pell expenditures in this simulation increase by just 3.3 percent.

Assets have so little effect on aid eligibility because few households have assets that are included in the formula. Families hold the vast majority of their wealth in homes and retirement funds, both of which are protected by the aid formula.[24] Other financial assets count only if they are above a threshold that increases with the age of the parents (up to $54,500). Among dependent students who file a FAFSA, 85 percent have no assets above the disregard. Among those from families with income below $50,000, it's 93 percent.[25] As a result, for the overwhelmingly majority of families the effective tax rate on assets is already zero – yet the data on assets are still gathered.[26]

It could be the case, however, that families with substantial assets simply do not file a FAFSA, since they know they will not be eligible for aid. In this case, the students filing a FAFSA would be unrepresentative of the entire population of college students, and our proposed simplification would be more expensive that the FAFSA simulations would suggest. We can

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[23] A rejoinder is that assets serve as a summary statistic for lifetime earnings, which are imperfectly captured by current earnings. Rather than use assets as a proxy for lifetime earnings, we could instead use Internal Revenue Service data to directly measure multiple years of earnings. We consider this a sensible option worth consideration.

[24] *All* asset information is excluded from the aid calculation for families that qualify for the "simplified needs test" or "automatic zero EFC," both of which we discuss later in the paper.

[25] Authors' calculations from NPSAS.

[26] For 99 percent of aid applicants, the marginal tax rate on assets is zero. We obtain this figure by adding $100 to every applicant's financial assets and recalculating aid. For 99 percent of the sample, Pell eligibility is unchanged.

easily check on this by comparing assets of current FAFSA applicants to assets of all households with similar incomes. We do so using data from the 2004 Survey of Consumer Finances, focusing on households that contain children and have income of below $50,000 (the effective income cap for Pell eligibility). Among all such households, the 50th percentile of non-retirement financial assets is below $1000 and the 95th percentile is below $40,000.[27] The analogous figures for dependent Pell recipients in NPSAS are $200 and $31,000.[28]

These figures indicate that the assets of households currently applying for aid are quite similar to the population that could apply for aid. These statistics offer no support for the fear that a substantial, hidden population of low-income, high-asset families will gain Pell eligibility if assets are completely removed from taxation. This is not to say that there *no* such families will gain eligibility: 0.25 percent of families with income in the Pell range have more than $250,000 in non-retirement financial assets. But this is a minute portion of the population, and so the program costs of "wrongly" giving Pells to such asset-rich, income-poor families are low. By contrast, the resulting reduction in compliance costs is large once it is aggregated across the other 99.75 percent of households.

Approach C: Distribute Aid Using Income and Family Structure, Dropping All Assets and Dependent Students' Earnings

The aid system's treatment of student earnings is deeply flawed, from both an equity and efficiency standpoint. The aid formula taxes student earnings (over an income protection

[27] Authors' calculations from the 2004 Survey of Consumer Finances. Figure is for households with children and incomes below $50,000.The 99th percentile of financial, non-retirement assets for this population is roughly $160,000.

[28] The 99th percentiles of non-retirement financial assets for dependent and independent Pell recipients are $95,000 and $13,000, respectively.

allowance of $2,550) at a rate of fifty percent. [29] Variation in students' earnings is driven predominantly by work hours, rather than variation in hourly wages. As a result, this is a tax on students' work effort, and may serve to discourage work. Further, the tax falls more heavily on low-income households, since both student work effort and earnings are drop as parental income rises. While 73 percent of dependent students from lower-income families have positive earnings, the figure is 62 percent for students from upper-income families.[30] Median student earnings are $2,730 for the lower-income group, as compared to $2,231 for the upper income group.

We therefore next exclude dependent students' earnings from the calculation of aid, and limit the required data items to parents' income, parents' marital status, family size, and number of family members in college. The Pell Grants of seventy-two percent of aid applicants are essentially unchanged; the correlation of this simulated Pell grant with the current Pell grant is 0.88. In Figure 4, we plot the associated changes in Pell Grant eligibility against income. Pell Grants increase most for those whose parents earn between $15,000 and $40,000 per year.

Since discarding dependent students' earnings mechanically increases calculated need, three times as many applicants would see a significant increase ($500 or more) in Pell eligibility as would see a significant decrease. As a result, this the most expensive approach so far discussed, with average Pell Grants increasing by $185 per applicant (11.5 percent); grants change only for dependent students (for independent students, approaches B and C are equivalent).

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[29] In 2007-2008, the disregard will rise to $3,000 and the tax rate will fall to 35 percent. Students also receive allowances for federal taxes paid and an estimate of state taxes paid. If parents' total allowances exceed parents' income, the excess parents' allowance is used to protect more of the student's income.

[30] We divide families at the rough median of household income, $50,000.

Summary of Results

In this section, we have exhaustively demonstrated that the progressivity of the federal aid system *does not* require its current complexity. The length of the FAFSA, and the number of data items used in the aid formula, could be massively reduced without changing the progressivity of the Pell or increasing program costs (Simulation A and B). An even more radical reduction in complexity can be achieved with a small increase in program costs (Simulation C). The three approaches described thus far simply drop particular items while keeping the formula itself unchanged. This means that dropping items such as assets or student earnings mechanically increase the cost of the program. But the formula itself could also be modified to enhance clarity and preserve cost-neutrality. In the next section, we describe a policy that radically simplifies financial aid in exactly this way.

The Feasibility of Delivering Student Aid Through the Tax System

We have shown that the formula for calculating Pell Grants could be drastically simplified with little effect on total program costs or the distribution of aid. But changing the formula without changing the overall process for accessing aid is unlikely to substantially reduce the complexity, confusion, and uncertainty faced by students and their families. In this section we describe how Pell Grants could be combined with the existing Hope and Lifetime Learning tax credits to form a single, streamlined credit.[31] We preserve the level and distribution of benefits by creating a new grant that is roughly the sum of Pell, Hope and Lifetime Learning eligibility by income class. We describe how delivery of the credit could be improved to enable families to better predict their eligibility and to receive funds at the time of actual college

[31] Although our initial focus was on simplifying the Pell Grant, if the Pell Grant were simplified enough to run through the tax system, it seems natural to further simplify by combining these grants with the existing tax benefits for higher education.

enrollment, rather than several months later. Economic theory and our own empirical analysis suggest that this program could be much more efficient and effective than the jumble of grants and tax incentives currently in place.

Eligibility: A sample grant table is shown below. The grant amounts listed in the table roughly reflect the sum of the current Pell Grant, Hope and Lifetime Learning credit eligibility for each income category. The table is small enough to fit on a postcard and be prominently displayed on posters in high school hallways. Note that subsidized student loan eligibility could be assigned using the same table, with eligibility either dependent upon income or set as a flat amount for all students.

Exhibit 1. Federal Student Aid, on a Postcard

How much federal aid can I get to help pay for college?

If your parents' adjusted gross income is…	then your grant is…
$0-$14,999	$4,500
$15,000-$19,999	$4,250
$20,000-$24,999	$3,750
$25,000-$29,999	$3,250
$30,000-$34,999	$2,650
$35,000-$39,999	$2,100
$40,000-$44,999	$1,475
$45,000-$49,999	$1,175
$50,000 -$59,999	$1,000
$60,000 -$74,999	$750
$75,000 -$99,999	$500
$100,000 or higher	$0

*If you are legally independent from your parents, your aid will be based on your (and your spouse's) income.

Application Process: Families could apply for the grant by checking off a box on their income tax return. In return, families would receive a voucher in the mail, to be applied towards the cost of attendance at any eligible higher education institution. Students would notify schools

of their grant eligibility as part of the normal application process. Schools would verify this information electronically with the Department of Education, as they do now with information from the Student Aid Report. Financial aid administrators would verify students' enrollment status for the Department of Education (grants will be prorated for part-time students).

Program Administration: While IRS has all the data needed to determine grant eligibility, it is the Department of Education that has the infrastructure in place to deliver funds to schools. The role of the IRS could thus be limited to forwarding applicants' adjusted gross income and dependency status to the Department of Education, which would calculate aid eligibility and send students their vouchers. Just as in the current system, eligibility for the 2006-07 school year would be based on 2005 income, as reported to the IRS in early 2006. Unlike the current system, students would not have to wait for their voucher to arrive to know exactly how much they will get, because they can look it up in the simple table (Exhibit 1).

Advantages

- *Simple and predictable.* The grant schedule is so simple that families can easily determine their eligibility themselves, before they file their taxes, and years before their child applies to college.
- *Less paperwork.* Families applying for aid will report their income to the IRS as they usually do, when they apply for taxes. They will not have to make a separate report to the Department of Education.
- *Families get funds when they need them.* Right now, the tax credits arrive up to 16 months after families have paid for college tuition. The credits do nothing for the strapped family who just can't come up with the funds for college. Our approach gets money into families' hands when they are paying the college bills.
- *One grant program.* Our approach combines the Pell and tax credits into a single, unified program. This reduces paperwork for families, cuts confusion about eligibility, and eliminates the byzantine rules that determine how tax credit eligibility changes when aid rises and vice versa.

Costs of Aid Simplification

Our goal is to increase the efficacy of the aid dollars we currently offer. The grant program just described is *revenue-neutral* if there is zero behavioral response (as is typically assumed in budget forecasts). That is, if people go to college and apply for aid at the rate they do now, then this program would be no more expensive than the sum of current program spending. Current spending on the Pell is now $13 billion, while for the tax credits it is $6 billion. The cost of our unified grant is therefore about $19 billion.

Current spending levels reflect a current take-up rate of 65 percent in the Pell Grant program.[32] If 100 percent of those eligible for the Pell took advantage of it, the program's cost would rise to $20 billion from its current $13 billion. To put it differently, costs are kept artificially low in the Pell Grant program by its extremely onerous application requirements. This is one method for rationing scarce funds, but a highly regressive method. The cost of aid application, we have argued and shown, is highest for the very populations we putatively target with need-based aid. We have therefore proposed a vast simplification of the aid system, one that we hope would lead *all* eligible students to step up and receive their grant. If they did so, our proposed grant would not be revenue-neutral, but instead would rise to about $26 billion.[33]

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[32] We obtain this take-up rate by calculating Pell eligibility for all students in the NPSAS, not just those who fill out the FAFSA (NPSAS provides an estimated EFC for these students, which we use in the calculation). We compare this Pell eligibility to actual Pell receipt. We find that 58 percent of eligible students take up the Pell, while 65 percent of Pell dollars offered are taken up (that is, the Pell grants left on the table are relatively small). Others have estimated similar Pell takeup rates (American Council on Education, 2004).

[33] We estimate the costs of 100 percent take-up of our proposal using data from the October 2003 Current Population Survey. This survey provides nationally-representative estimates of the number of full- and part-time college students in each family income category. We multiply grant eligibility in each income category by the number of "full-time equivalent" students in each category, and sum to reach the $26 billion estimate.

A Note on Loans

The grants proposed are sufficient to cover tuition at community colleges and at many public universities. They would not cover living expenses, or tuition at the more expense public universities. As is the case now, loans would be necessary to cover the shortfall. We chose to focus the paper on grants, to emphasize the point that existing grants and tax credits could be distributed simply with no negative impact on progressivity. We can easily apply the same concepts and analysis to subsidized Stafford loans, and assign them based on income alone.

In an ideal world, we would pair the simplified grant discussed in this paper with a generous, income-contingent loan program similar to those operating in Australia, New Zealand and the UK (Chapman, __; Barr,__). In these programs, former college students repay their loans as a percentage of their payroll earnings. This "forward-looking" needs-analysis approach has good distributional characteristics: the beneficiaries of college pay for its costs, but they are insured against bad labor market draws that would saddle them with unsustainable loan payments.[34]

Barriers to Aid Simplification

Aid simplification produces winners and losers. Losers are inevitable when simplification is constrained by revenue neutrality, as noted by the Final Report of the President's Commission on Tax Reform. The only way to simplify and keep everybody whole is to increase spending.

Even producing winners can cause political problems. Winners are those whose estimated ability to pay drops when we shift to a simpler measurement of income. By implication, many

[34] We have costed out such a program, and generated the required "tax" tables. We found that the discussion of these results was muddying and lengthening the paper, and so cut them out. We are happy to discuss folding them back in.

families who do not currently "deserve" aid will get it under a simplified system. Some will perceive the receipt of aid by such students as fraud, or evasion, or a policy failure. We perceive it as a cost of simplification, outweighed by the benefits it confers on the vast majority of students but especially upon the student teetering on the margin of entering college.

While the political barriers to aid simplification are substantial, the bureaucratic barriers may be even greater. Over the years, Congress has passed several provisions aimed at simplifying the aid formula. In 1986, Congress mandated an "automatic zero" EFC for families with taxable income below $15,000 who are also eligible to file an IRS Form 1040A or 1040EZ. These applicants can potentially skip more than 50 of the over 70 financial questions on the FAFSA. Congress also mandated a "simplified needs test" for families earning less than $50,000 who are eligible to file the 1040A or 1040EZ; for these families, asset information can be disregarded.

While laudable in intent, these efforts have been ineffectual. As implemented, these simplifications have had virtually no impact on the aid system *as it is experienced by students and parents*. In our sample, just half of applicants from families with income between $5,000 and $15,000 had their applications processed using the automatic-zero EFC or simplified needs test. Even among the applicants whose FAFSAs were flagged as having received this simplified treatment, the evidence indicates that the *student's* application experience was not simplified. Among those who had their FAFSA processed using the simplified needs test, and who were eligible to skip the asset questions, 48 percent provided asset information. Among those who had their application processed under the automatic-zero EFC formula, 90 percent had responded to questions that they were not required to answer. For example, 63 percent had non-zero amounts reported in Worksheet A and 30 percent reported non-zero assets.

In effect, simplification has only made things easier for the computer that processes aid applications. Simplifications are not communicated to students and their families; they are never mentioned on the paper FAFSA, used by about half of dependent, undergraduate applicants with incomes below $50,000.[35] Even the online FAFSA only offers the option to skip the relevant questions mid-application, and then warns that some schools may require that the questions be answered (U.S. Department of Education, 2005c). This phrasing will frighten many students into filling in the complete application.

An additional barrier to simplification has been the states, who run their own aid programs. Thirty-two states have rejected the federal simplifications, requiring the full FAFSA data from applicants; in these cases, applicants using the web FAFSA never see a window that allows them to skip questions. This imposes large compliance costs for all applicants in order to distribute small amounts of aid to a few students. In half of the states, need-based grants average less than $200 per undergraduate (National Association of State Student Gant and Aid Programs, 2005). By comparison, Pell Grants average $1,100 in our sample of dependent undergraduates.

It is with this history in mind that we have proposed the whole-system reform described above. Instructions to the Department of Education to simplify the aid process have proved futile. Congressional action, and not agency reforms, will be needed to implement our proposal.

Conclusion

There is no doubt that the need-based aid system gets grants and loans to many low-income families who would be worse off without it. There is little to no evidence that this aid has the behavioral effect it is intended to have: getting more young people into college. In this

[35] Authors' calculations from NPSAS:04.

paper, we have described a radical simplification to the aid system that would preserve its distributional intent while enhancing its positive impact on schooling decisions.

We find that provisions intended to precisely target aid to those with the lowest ability to pay unintentionally produce regressive compliance costs. Behavioral economics suggests that minor differences in program design can have profound impacts upon the equity and efficiency of student aid. We identify multiple aspects of the aid system that behavioral economics suggest will blunt its impact upon schooling decisions.

The basics of need-determination have changed little since they were laid out fifty years ago. At a College Board conference in 1953, John Monro, then-dean of admissions at Harvard College, described to his colleagues at other elite colleges the formula he had been using to distribute aid to Harvard admits. The assembled college administrators were eager to establish a common formula for assigning aid, so that they could quash the competitive bidding for the best students that that had recently developed. Within a year, a common aid application was in use (the Parents' Confidential Statement) and the new College Scholarship Service (CSS) had been established by 94 charter members (Duffy and Goldberg, 1998; Wilkinson, 2005).

Then, as now, Harvard and other elite schools sought exhaustive measures of wealth and income to tailor their scholarships.[36] Today's FAFSA and aid formula reflect this peculiar history, providing extremely fine measures of ability to pay at levels of income that far exceed the effective cutoffs for federal aid. While these distinctions are critical at institutions that provide need-based grants to families with incomes well above $100,000 (Dynarski, 2004b), we have shown such fine measures are irrelevant for the distribution of Pell Grants.

The U.S. system for subsidizing college students hides information about the affordability of college behind a thicket of paperwork. It delays sharing information about the

[36] Until 1973, the aid application asked about make and model of the family car (Wilkinson, 2005).

affordability of college until it is too late. It is time for the federal aid system to uncouple itself from the needs of the Harvards, and concentrate on the needs of young people unnecessarily dissuaded from college by the impression that it is not affordable.

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Appendix

Data

Student aid statistics and simulations are based on restricted-use, individual-level data from the nationally representative 2003-04 National Postsecondary Student Aid Survey (NPSAS:04). NPSAS:04 includes data from the Free Application for Federal Student Aid (FAFSA) for 56,440 undergraduate federal aid applicants. We limited our sample to 26,156 full-time undergraduates (dependent or independent) who attended the same institution for the full year. From this sample we drop 1,733 individuals who were missing an EFC, as well as 170 individuals missing other critical data elements such as income or family size. This results in a final sample of 24,253 individuals.

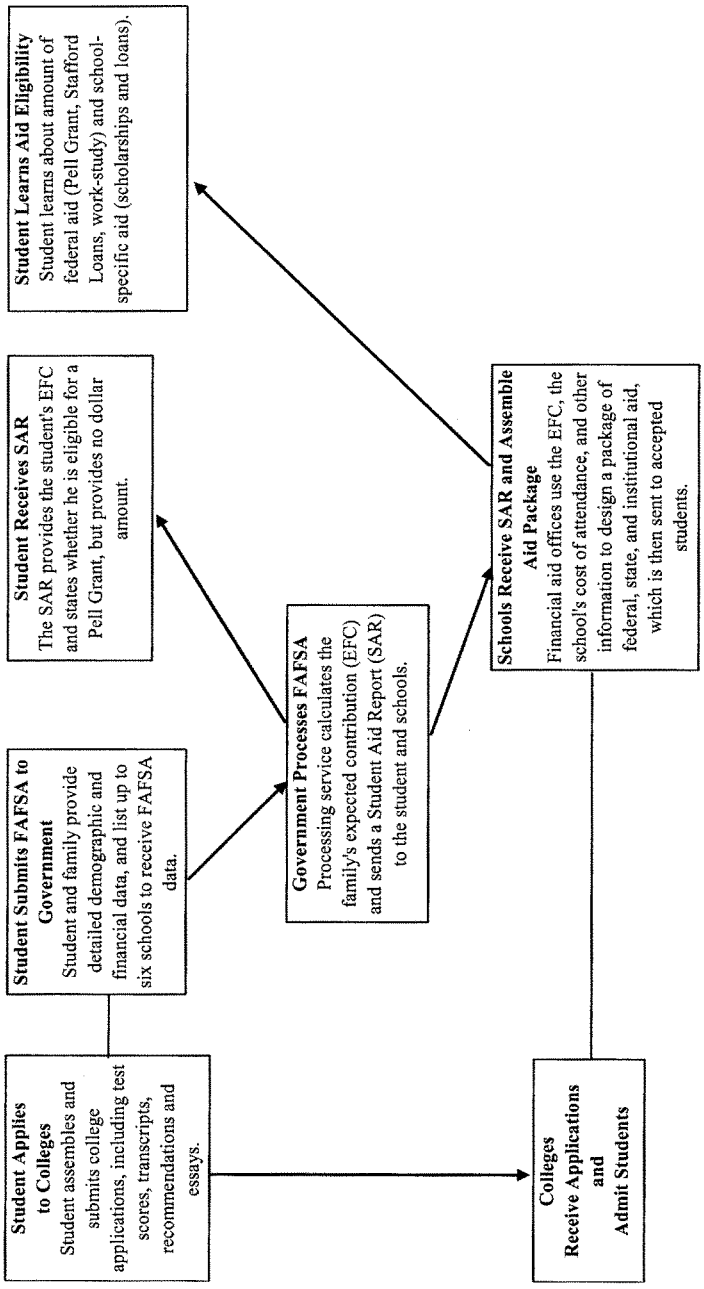
Aid Formula

To replicate the student's Pell eligibility, as well as to test the consequences of formula simplification, we coded EFC, Pell, and Stafford loan formulas and rules for dependent students as outlined in the 960-page *2003-2004 Federal Student Aid Handbook*.

The EFC formula sums parents' adjusted gross income (or W-2 earnings for non-tax-filers) and other income, subtracts a number of allowances (of which the largest is the amount of taxes paid), and adds in 12 percent of assets over an asset protection threshold that depends on marital status and elder parent's age. Marginal assessment rates from 22 to 47 percent are applied to this total (called parents' "adjusted available income"). The result is divided by the number of children in college to obtain the parents' expected contribution. The student's expected contribution is computed by adding student's adjusted gross income and other income, subtracting a few allowances, and applying a 50 percent assessment rate. 35 percent of any student assets are added to this figure to yield the student's expected contribution (students have no asset protection allowance).

The Pell award is estimated by subtracting the EFC from the maximum Pell Grant ($4,050). Following federal rules, grants between zero and $199 are rounded down to zero and grants between $200 and $399 are rounded up to the minimum grant of $400. Pell Grants over $2,700 are adjusted downwards for students at very low-tuition institutions (tuition and fees less than $675, in 2003-2004) using what is called the "tuition sensitivity adjustment." Pell Grants are also reduced if the calculated amount exceeds the cost of attendance at the student's institution (which is provided in NPSAS, as reported by the schools). In our sample, the tuition sensitivity adjustment applied to only 35 people and the cost of attendance adjustment applied to none.

Figure 1. The Student Aid Application Process



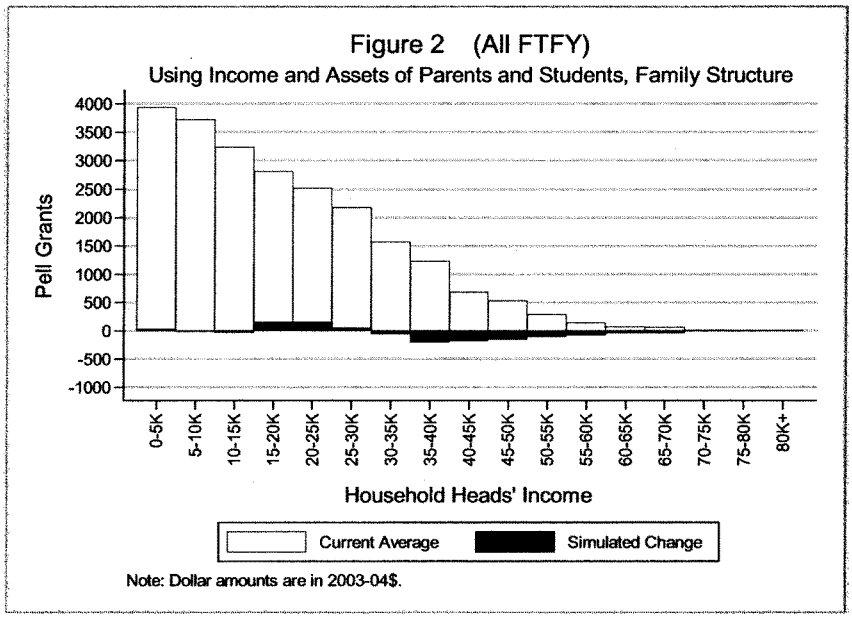


Figure 2 (All FTFY)
Using Income and Assets of Parents and Students, Family Structure
Pell Grants
4000
3500
3000
2500
2000
1500
1000
500
0
-500
-1000
0-5K
5-10K
10-15K
15-20K
20-25K
25-30K
30-35K
35-40K
40-45K
45-50K
50-55K
55-60K
60-65K
65-70K
70-75K
75-80K
80K+
Household Heads' Income
Current Average
Simulated Change
Note: Dollar amounts are in 2003-04$.

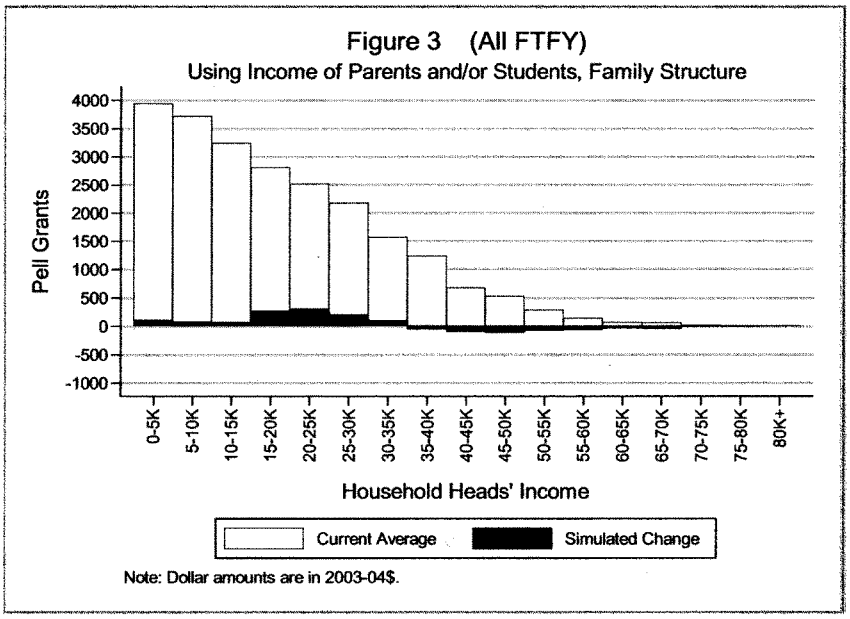


Figure 3 (All FTFY)
Using Income of Parents and/or Students, Family Structure
Pell Grants
4000
3500
3000
2500
2000
1500
1000
500
0
-500
-1000
0-5K
5-10K
10-15K
15-20K
20-25K
25-30K
30-35K
35-40K
40-45K
45-50K
50-55K
55-60K
60-65K
65-70K
70-75K
75-80K
80K+
Household Heads' Income
Current Average
Simulated Change
Note: Dollar amounts are in 2003-04$.

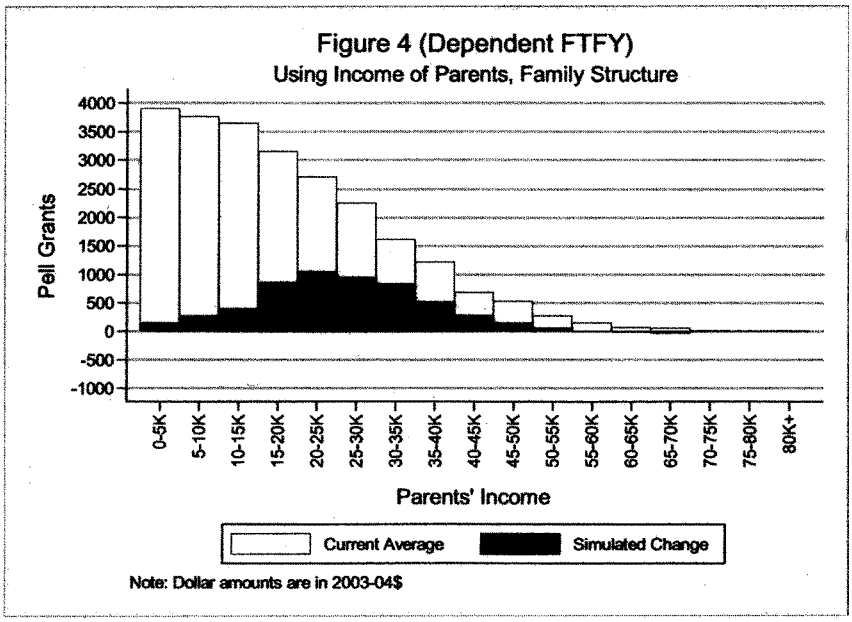


Figure 4 (Dependent FTFY)
Using Income of Parents, Family Structure
Pell Grants
4000
3500
3000
2500
2000
1500
1000
500
0
-500
-1000
0-5K
5-10K
10-15K
15-20K
20-25K
25-30K
30-35K
35-40K
40-45K
45-50K
50-55K
55-60K
60-65K
65-70K
70-75K
75-80K
80K+
Parents' Income
Current Average
Simulated Change
Note: Dollar amounts are in 2003-04$

Table 1. Complexity of the FAFSA Versus IRS 1040

Measure	1040 2005	1040A 2005	1040EZ 2005	FAFSA 2006-2007
Number of pages (excluding instructions)	2	2	1	5
Total number of questions	118	83	37	127
Non-financial items				
Identifying information	6	6	6	22
Demographic/family information	8	8	2	18
Enrollment status/school info.	0	0	0	7
Signature and preparer info.	12	12	12	8
Other	1	1	1	10
Financial items				
Earned income	1	1	1	5
Other income	19	12	2	33
Assets	0	0	0	6
Deductions/credits/allowances	39	22	2	12
Tax amounts from tables, calc. lines	21	12	6	6
Withholdings, refund prefs.	11	9	5	0
Number of items required for computation of tax/refund or aid amt.*	71	43	8	72
Length of signing statement	49 words	64 words	59 words	232 words
Official estimate of time to prepare**	16 hours	13 hours	8 hours	1 hour

Source: Authors' counts unless otherwise noted. Counts for the FAFSA are for dependent students with two parents, and includes questions on required student and parent worksheets. Total number of questions includes subquestions and non-numbered questions, and ensures that items such as name and address are counted in the same way on both IRS and FAFSA forms.

*For the FAFSA, this excludes items required only to determine dependency status or general eligibility for federal aid.

**Estimates from official Paperwork Reduction Act notices in the instructions accompanying each form. IRS-reported estimates of time and cost of preparation are based on non-business filers who self-prepare without tax preparation software (these estimates can be found in each form's instructions, on page 78, 58, and 23, respectively). The FAFSA estimate can be found on page 7 of the FAFSA.

Table 2. Consequences of Aid Simplification

	Baseline	Approach A *Drops taxes paid, type of tax form, and worksheets*	Approach B *Additionally drops assets*	Approach C *Additionally drops dependent students' earnings*
Percent of all full-time full-year applicants whose Pell…				
...remains the same (within $100)	1.00	0.76	0.75	0.72
...increases by $500 or more	0.00	0.05	0.07	0.12
...decreases by $500 or more	0.00	0.07	0.06	0.04
Correlation between new and old Pell Grant	1.00	0.96	0.95	0.92
R-squared	1.00	0.92	0.90	0.84
Change in average Pell (per full-time full-year applicant)	0.00	-13.61	53.79	185.17
Percentage change in total program costs*	0.00	-0.84%	3.34%	11.48%
Variables included in simulation:				
Assets	Y	Y		
Dependent students' AGI	Y	Y	Y	
Parental AGI, or independent student/spouse's AGI	Y	Y	Y	Y
Parental or independent students' marital status	Y	Y	Y	Y
Family size	Y	Y	Y	Y
Number of family members in coll.	Y	Y	Y	Y
Number of FAFSA items required for simulation**	72	14	8	6

SOURCE: Authors' calculations using FAFSA data from NPSAS: 2003-2004. Sample is limited to 24,253 students (dependent or independent) who attended a single institution full time for the full school year and who were not missing key data elements such as income or actual EFC.

*Estimated total Pell expenditures for this sample of full-time, full year aid applicants are $7.6 billion. Total Pell expenditures across all applicants were $12.7 billion in 2003-04.

**Count refers to the number of questions on the 2003-2004 FAFSA required to elicit the items used in the simulated needs analysis. For example, eliciting AGI requires 3 questions on the FAFSA, because non-tax filers must report their earnings and their spouses' earnings. The count does not include questions used only to determine dependency status or questions unrelated to the calculation of need. The differences between the 2003-2004 and 2006-2007 FAFSA described in Table 1 are minor.

Responses to Questions for the Record From Dr. Susan M. Dynarski
December 5, 2006

In your testimony, you proposed that the Senate Finance Committee consider legislation to combine the Pell Grant and HOPE Scholarship/Lifetime education tax credits into one refundable education tax credit. Please provide additional detail about the determination of the amount of your proposed credit and its administration. Would one grant instead of a tax credit be preferable? In your opinion, which Federal agency or agencies should administer a refundable tax credit?

Full details of my proposal are available in a recent working paper, which can be accessed at http://www1.hamiltonproject.org/views/papers/200702dynarski-scott-clayton.pdf.

The amounts of the grant that we propose are roughly based on the combined amounts of the current Pell and current tax credits for each income bracket. We also sought to hold students harmless: we did not want any students to see a reduction in their funds when we transitioned to a unified credit/grant. A major simplification of the eligibility process, as we propose, inevitably produces winners and losers if the proposal is constrained to be revenue-neutral. We propose a moderate increase in the total amount given to each student in order to avoid harming any in the transition.

I believe that it is best that funds be delivered through schools, who will then pass funds (net of tuition) to students. This approach prevents fraud: the student has to actually register and enroll to get the money. This is the system currently used by the Department of Education in delivering the Pell grant and Stafford loans.

Our current tax credits go directly to the student, rather than the school. There is much less concern about fraud in this case, however, because the back-loaded credits are triggered by the student showing (and the school certifying) that the student indeed had schooling expenses.

While the back-loaded approach reduces fraud, it also means that the credits don't arrive when students really need them, when they enroll in school. So how do we design a system that gets money to students when they need it and also minimizes fraud? The Department of Education already has such a system in place. It is used to deliver the Pell Grant and Stafford Loan to students and their schools. It makes sense to make use of these established resources to deliver funds.

In a recent Hamilton Project paper I laid out how IRS and ED could work together to minimize application paperwork and get grant funds to students when they need them. The gist of the proposal is that the family checks a box on their 1040 to indicate that a household member wants funds for college. IRS sends data on AGI and number of

dependents for this household over to ED. ED uses a simple lookup table to determine grant eligibility, and notifies the student of her eligibility. When a student applies to and enrolls in a college, she authorizes the college to obtain her funds (as is currently the case).

Regarding a refundable education tax credit, would it be feasible to include an allowance for room and board?

I do not believe that the grant/credit should be capped by tuition. For those attending community colleges and public universities, room and board are the bulk of expenses. A program that is capped by tuition costs does little for this 80% of students at public schools. It primarily benefits those at the most expensive private schools, and these are not the students who need a helping hand to get them into college.

I would therefore include an allowance for room and board in the grant. For the sake of simplicity and certainty (which are critical, if the program is to be easily communicated and effective) I would make this a flat sum, rather than link it in any way to actual room and board costs.

Senate Testimony of Daniel Golden
December 5, 2006

Good morning, Mr. Chairman and members of the Committee. My name is Daniel Golden, and I am the deputy chief of the *Wall Street Journal's* Boston bureau, where I cover education. I am also the author of the recently-published book, "The Price of Admission," which reveals the extent of admissions preferences for wealthy and well-connected applicants at the Ivy Leagues, Duke, Stanford, Notre Dame, the University of Virginia and other leading colleges. Thank you for inviting me to testify.

I would like to begin by summarizing the key findings of my research, followed by brief comments on its implications.

Overall, the research documented in my book demonstrates that elite colleges and universities use admissions to generate revenue, enhancing their already massive endowments. Their favoritism toward the wealthy undermines equal opportunity and upward mobility in our society.

This conclusion draws on many specific findings.

- **Four major preferences favor affluent candidates in admissions to selective private and public colleges.** I estimate that nearly one-third of students admitted to some elite colleges receive special consideration due to these "preferences of privilege"—far more than those who enjoy an edge due to affirmative action.

The first is the preference for alumni children, who make up about 10% to 25% of the student body at elite colleges. Legacies, as they are called, gain admission at two to four times the overall rate. I estimate that legacy applicants enjoy a 50 to 75 point advantage on the old 1600-point SAT scale over students who do not receive any preference.

Colleges defend legacy preference on the grounds that it's valuable to maintaining tradition over generations. However, that doesn't explain why the child of a rich alumnus who is a major donor receives a larger preference than the child of a poor alumnus who can't afford. For example, my research indicates that about half of all the children of Harvard's 425 biggest donors, most of whom are alumni, enroll at Harvard—a university that only accepts one out of 10 applicants overall. Another study of Harvard admissions found that if a legacy applicant needed financial aid, the alumni-child boost disappeared almost entirely. It's worth noting that, although social class

distinctions are widely considered more pervasive in England than in the United States, England's two most famous universities, Oxford and Cambridge, do not ask about or consider legacy status in admissions.

Children of influential alumni who are also major donors may enjoy an SAT boost of 300 points or more. In 1998, for instance, Stanford only admitted one of nine applicants from the Groton School, a Massachusetts prep school. Among those rejected was Henry Park, a middle-class Korean-American with a 1560 SAT score and high class rank. The only Groton applicant Stanford admitted was Margaret Bass, who had a 1220 SAT score—340 points lower than Henry—and was in the middle of the class. Her father, oil magnate Robert Bass, a graduate of Stanford's business school, was chairman of the university's board at the time and had given Stanford $25 million. Mr. Bass's other three children went to Stanford, as well as Harvard and Duke, to both of which he has made multi-million dollar donations.

The second preference of privilege favors what are called "development cases"—applicants recommended by the development, or fundraising office because if they are admitted their non-alumni parents are expected to provide money or visibility. The parents may be corporate executives, Hollywood celebrities, or leaders in politics or the media. The number of development cases in a freshman class may range from half a dozen to a hundred, depending on the university.

In 1999, for instance, Brown University's president, Gordon Gee, prevailed on its admissions staff to accept Chris Ovitz, the son of prominent Hollywood agent Michael Ovitz. Although Chris was not in the top 20% of his prep school and did not take many advanced classes, Mr. Gee hoped to cultivate Mr. Ovitz and his formidable client list. Although Chris dropped out in less than a year, a grateful Mr. Ovitz later brought celebrity clients such as Martin Scorsese and Dustin Hoffman to Brown for campus events, enhancing the university's prestige.

The third preference of privilege helps athletes in blue-blood sports. Television viewers of college basketball and football tend to assume that college sports are racially and economically diverse. But colleges also give admissions breaks to athletes in many prep-school sports that most American children rarely have a chance to play: crew, horseback riding, sailing, squash, even polo. The way elite colleges and universities have responded in recent years to Title IX, the gender equity law, has worsened this socioeconomic inequity. They have started women's teams primarily in crew and equestrian events while eliminating men's teams in more working-class sports such as wrestling and track and field.

The last preference of privilege benefits children of university faculty and administrators. This admissions break is most pronounced at universities that provide free or discounted tuition only to faculty children who attend their own institution and not to those who enroll elsewhere.

Although the tax-exempt benefit is available to all employees, in practice children of faculty and administrators apply more often to the elite colleges that employ their parents than do the offspring of lower-wage workers. Since faculty and administrators are highly educated—and much research shows that student achievement is linked to the parent's education level—their children should not need an edge. Nevertheless, to avoid offending colleagues, admissions officials sometimes lower standards to admit their children, who may comprise as much as 2% or 3% of the student body.

- **Elite colleges give special treatment to wealthy, well-connected applicants at each stage of the admissions process.** While most applicants are interviewed by alumni or admissions staff, privileged students often enjoy personal interviews with the dean of admissions. Key administrators at universities such as Duke and Brown have combined the supposedly separate functions of fundraising and admissions—by courting donors and also recommending their children for admission.

Some colleges have institutionalized backchannel routes to admissions for well-connected applicants, such as Harvard's Z-list. Most students on the Z-list are children of alumni and donors, sometimes with borderline credentials. Although they may be told informally that they're likely to be accepted, they are placed on the waiting list until the school year ends. Then they're quietly admitted not for the following September but for the year after.

The preferences of privilege augment other advantages for the wealthy in America's educational process. Affluent students typically attend excellent elementary and secondary schools and can afford tutors, SAT test-preparation courses and independent college counselors. All of these factors help explain why an estimated three-fourths of the students at America's elite colleges come from the top quartile in family income—and only about 5% to 10% from the bottom quartile.

- **Preferences for the privileged directly exclude highly talented candidates who are not wealthy or connected.** To be sure, many children of alumni, donors and faculty are brilliant candidates who

would likely have been admitted on merit. But, since elite colleges admit only one in eight or ten applicants and rarely increase their overall enrollment, when they lower the bar for other privileged children, they make room by turning away many outstanding middle-class and working-class applicants, predominantly whites and Asian-Americans. As Notre Dame's admissions dean told me, "The poor schmuck who has to get in on his own has to walk on water."

Sometimes walking on water isn't enough. Without any test preparation course, Jamie Lee achieved perfect scores on the SATs and two out of his three SAT2 subject tests. He received high school honors for creativity in mathematics, and was a promising violinist and composer. Yet of the seven schools to which he applied, five rejected him and the other two placed him on their waiting lists.

Or consider Jonathan Simmons, a high school valedictorian from a low-income family, and a devout Catholic, who was turned down by Notre Dame. It accepted his classmate, Kevin Desmond, who had lesser grades and test scores. Kevin's father, grandfather, three uncles and five older siblings had all attended Notre Dame and the family endowed a scholarship there.

I'm not saying that colleges do—or should—evaluate applicants on the basis of test scores and grades alone. They also consider extra-curricular activities, essays, recommendations and the like. But no matter which of these criteria a college uses, preference based on parental wealth and privilege is not consistent with a merit-based admissions process.

- **Raising money by compromising the admissions process is taking the easy way out—and is not the only way for elite colleges to maintain quality.**

  Some college administrators have acknowledged to me that the preferences of privilege are fundraising tools. But they contend that they have no choice because they need contributions from wealthy parents to support laboratories, scholarships, faculty salaries, and other expenditures. Certainly those are worthy causes. But I wonder how much more money colleges need, with Harvard's endowment at $29 billion, Yale's at $18 billion, and so on.

  In my book, I profile three fine institutions—California Institute of Technology, Berea College, and The Cooper Union for the Advancement of Science and Art—which admit students purely on merit and yet are still able to raise ample endowments, in part through

> creative approaches to fundraising. For instance, Gordon Moore, the co-founder of Intel Corp., who earned his doctorate at Caltech, gave $600 million to the institute. Mr. Moore's two sons didn't go there, but he received a different reward: Caltech named an asteroid after him.

Berea College, in Kentucky, educates the best and brightest of Appalachia's rural poor. It won't even admit any students from families earning more than $50,000 a year. Yet its per-student endowment is as big as Wellesley's and Dartmouth's, because thousands of alumni and non-alumni alike admire its mission and donate with no hope of an admissions quid pro quo.

Turning now from findings to implications, I want to comment briefly on the nonprofit, tax-exempt status of America's elite private colleges. This status confers on them a social responsibility. For instance, Harvard declares in its tax filing that it aims to "educate the future leaders of America" and "improve access to a Harvard education."

Reflecting this mission, such colleges describe themselves as "need-blind"—meaning that admissions decisions do not take into account a candidate's need for financial aid. But the finding of my research is that even if colleges are "need-blind", they are not "wealth-blind"—that is, they offer advantages to the wealthy and connected in admission, to the detriment of young people of outstanding talent born to less well-off or prominent parents.

In a recent interview in the *Wall Street Journal,* Princeton president Shirley Tilghman was asked to justify legacy preference. She responded with admirable candor that alumni are "extremely important to the financial well-being of this university."

The reporter, John Hechinger, followed up, "And wouldn't they continue to be even if you didn't give their children the preference?"

President Tilghman responded, "We've never done the experiment."

I would encourage America's elite universities to try that experiment—to eliminate the preferences of privilege and open their doors to the best applicants, regardless of wealth.

Drake
UNIVERSITY

December 4, 2006

Sen. Charles E. Grassley
135 Hart Senate Bldg.
Washington DC 20510-1501

Dear Senator Grassley:

I know that issues of access, affordability, transparency and accountability in higher education are very much on the public agenda these days, as they should be, and I commend you for bringing them into focus. I am also delighted to be asked to provide you with an overview of the efforts that Drake University has made to: 1) keep costs down (and thus keep tuition as low as possible); 2) provide access to a Drake education for low-income families, and; 3) make our operations as transparent and comprehensible to the public as possible. I do want to emphasize from the outset that while I do of course consider Drake University to be a model of good practice, we are by no means unique. I know from meetings and conversations with colleagues around the country that many in the higher education community are working diligently to address these issues.

In the interests of conserving space, I will outline our efforts in bulleted form; if you or your staff would like further information on any of these points, I will be happy to provide them (I have sent your staff some additional materials as context for these remarks):

Efforts to keep tuition costs as low as possible:

- It is important to emphasize that our decisions regarding tuition are not driven by the market but by the real costs of operation—compensation, financial aid, etc. Some costs, such as health care, utilities, scientific equipment, and library periodicals experience double-digit increases annually. In a number of fields (computer science/IT, business, pharmacy, for instance) the market rates for top faculty are increasing significantly. If we are to keep our promise to our students of the very best in education, we have to pay market rates to attract and retain the top people. It is also important to emphasize that tuition covers only 70% of the *real* cost of educating a student, and it must be subsidized by other sources (endowment income, annual giving, facilities rentals, grants and contracts, etc.);
- *Program Review*: an intensive 18-month process beginning in 2000 that eliminated $4 million in expenses and reallocated resources to match institutional priorities and goals (I have sent the introduction to the *Report of the President* as a separate document);

- *Strategic Budgeting*: a 3-year budget cycle emphasizes decision-making and prioritizing on the basis of the University's strategic goals; emphasizes *reallocation* rather than additions to budget;
- Outsourced many administrative functions to improve services and reduce costs (food operations; facilities management; print shop/mailroom; loan collection; annuity contracts oversight; COBRA/retirees premium collections)
- Funded an $11 million investment in HVAC infrastructure to increase efficiency and reduce energy costs;
- Reward performance—individual salary increases are not automatic and are based on merit;
- Salaries paid to senior administrators are carefully benchmarked to our peers on the national level (and we don't have coaches with seven-figure salaries!);
- New positions and position upgrades are not automatic and must meet the strategic objectives of the University:
- Total FT (non-grant funded) employees have increased by only 2% (from 752 to 769) since the fall of 1999 while student FTE has increased by 12% during that same period.
- Considerable efforts are underway to increase the University's endowment (which is quite modest) and contributions to Annual Fund, as well as to increase non-tuition revenues, all of which relieve pressure on tuition;
- As a result of these efforts, Drake University is listed as a "Best Buy" by several major college/university ranking publications; in the group of 12 private universities with whom we compete most for students, we are ranked at the top for academic quality, but 11th in cost.

Affordability/Accessibility:

- We have made a conscious and concerted effort to keep our tuition increases as low as possible—the average tuition increase at Drake in the past 8 years has been 4.1 %;
- The institutional commitment to student financial aid has increased $10.7 million, or 44.6%, in the past 6 years; the FY07 budget for institutional aid is over $36M, or 27% of the total institutional budget;
- Over 96% of Drake University undergraduates receive financial aid; on average, students received $10,700 in need-based scholarships and grants, so the net price actually paid by our students is significantly lower than the "sticker price." In addition, we are particularly concerned about making financial aid available to low- and middle-income students to ensure that they are able to afford a Drake education.

Transparency:

- In 2001, we adjusted our budget format so that it matches exactly the "operating activities" portion of our audited financial statements; readers of our audited financial statements can identify precisely our budgetary operating results (as well as key revenue sources and expenditure categories);
- Our budget plan includes a chart so that everyone can identify what the budget increases are to be used for and how those uses fit the strategic mission of the University; the plan is available to the entire community.

- Student and faculty representatives attend all Board of Trustees meetings (full Board and committees).
- President's annual tuition letter to parents and students discusses the factors that we consider in setting tuition and the key uses of the tuition increase;
- Annually, we offer a town meeting on budget results and share the details with the entire campus community; our annual audit is placed on reserve in the University library for anyone to review;
- We do a significant amount of benchmarking—financial and otherwise—with other institutions, using services provided by Moody's, Association of Governing Boards, Associated New American Colleges, College & University Personnel Association, and others. This benchmarking helps us judge our efficiency and effectiveness. The results are shared with our Board, the campus community and our peers;
- Through the generosity of Raytheon CEO Bill Swanson (a colleague on the Business-Higher Education Forum), we conducted an audit of administrative structure and practices, led by senior members of Raytheon's Six Sigma and internal audit teams;
- In 2004, our Board adopted a modified Sarbanes-Oxley (SOX) protocol;
- Goal 1, Objective 4 of the *Drake University Strategic Plan* states: "Develop a culture of evidence: information-based, ongoing assessment of key indicators of institutional quality and operations.

I hope that this information, and the other contextual materials that I sent to your staff, will be of help in your deliberations. I do want to emphasize in closing that our tuition—and tuition increases—are driven *only* by the costs of providing the highest quality learning environment for our students, and we work hard to keep those costs in line. I know that there are some in the public discourse who believe that the availability of Federal financial aid funds and tuition tax credits play a role in institutional decision making. However, as the President of Drake, I want you to know that while we fully support increases in Federal financial aid funds and tax credits for tuition payments, because they provide badly-needed assistance for our students and their parents—we decidedly do *not* see these initiatives as opportunities to raise our tuition and fees. To do so would be a violation of our ethical and moral standards as an institution, and undermine our commitment to access.

Sincerely yours,

David Maxwell
President

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CHARLES MILLER
CHAIRMAN

December 1, 2006

The Honorable Charles E. Grassley
Chairman, Finance Committee
135 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Grassley:

It is timely and urgent to give serious consideration to the financial and accountability structures of higher education and I offer comments after a year-long study of those issues in my role as Chairman of the Secretary of Education's Commission on The Future of Higher Education.

Higher education depends heavily on federal funds directly and through the tax system. An estimated one-third of all higher education revenues are derived directly from federal funds, through financial aid and research programs of the government. Very importantly, even private colleges and universities are estimated to receive twenty-five percent of their revenues from federal funds. In addition to direct funding, numerous federal tax benefits are available to families and to contributors and from endowment earnings. The tax code benefits are substantial in amounts, extremely important in the larger scheme of things and have a significant impact on the structure and performance of higher education.

Considering the size and importance of these taxpayer dollars, there is very little understanding of the use of these funds. Oversight and accountability of financial aid, research expenditures and tax policies in regard to higher education are inadequate. Accounting and administrative procedures are in place, but there is no strategic framework from the standpoint of either federal tax policy or higher education policy. We don't really know what we are getting for the enormous expenditure of public funds.

Because of the non-profit or tax exempt nature of most colleges and universities, there should be a strong fiduciary duty attached to these funds, including full financial and operational transparency and accountability. The federal government also has a duty in its role as a fiduciary for the taxpayer to assure transparency and accountability at a high standard. We need to do a great deal more than we are doing today to hold colleges and universities accountable for the enormous financial support they receive from the American taxpayers.

Two excerpts from the report of the Commission appointed by Secretary of Education Margaret Spellings are informative of the financial structure of higher education:

1. *"Our higher education financing system is increasingly dysfunctional. State subsidies are declining; tuition is rising; and cost per student is increasing faster than inflation or family income. Affordability is directly affected by a financing system that provides limited incentives for colleges and universities to take aggressive steps to improve institutional efficiency and productivity. Public concern about rising costs may ultimately contribute to the erosion of public confidence in higher education."*

2. *"The entire financial aid system---including federal, state, institutional, and private programs---is confusing, complex, inefficient, duplicative, and frequently does not direct aid to students who truly need it. Need-based financial aid is not keeping pace with rising tuition.*

   - *There are at least 20 separate federal programs providing direct financial aid or tax benefits to individuals seeking postsecondary education. The system is overly complicated and its multitude of programs sometimes redundant and incomprehensible to all but a few experts. This complexity has the unfortunate effect of discouraging some low-income students from even applying to college.*

   - *For the typical household, the Free Application for Federal Student Aid, or FAFSA, is longer and more complicated than the federal tax return. Moreover, the simplest IRS tax form, the 1040EZ, already collects most of the key pieces of data that could determine federal aid eligibility."*

A thorough and intensive review of the tax and financing policies of the federal government in its role of providing substantial funding of higher education is needed and would be an important contribution to America's future.

Sincerely,

Charles Miller

Charles Miller

CM/fw

cc The Honorable Margaret Spellings
U.S. Senate and House Finance and Education Committee Chairs
The Honorable Kay Bailey Hutchison
Commission Members

Engines of Inequality:
Diminishing Equity in the Nation's Premier Public Universities
By Danette Gerald and Kati Haycock

Special Thanks

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The Education Trust

About the Education Trust

The Education Trust, Inc. was created to promote high academic achievement for all students, at all levels—pre-kindergarten through college. While we know that all schools and colleges could better serve their students, our work focuses on the schools and colleges most often left behind in plans to improve education: those serving African American, Latino, Native American and low-income students.

The Education Trust works side-by-side with policy makers, parents, education professionals, community and business leaders—in cities and towns across the country—who are trying to transform their schools and colleges into institutions that genuinely serve all students. We also bring lessons learned in local communities back to Washington to help inform national policy debates.

As one country after another passes us by in the education of its children, Americans are growing increasingly worried. At some deep level, we all understand that the rules of the game are changing—that today's American Dream isn't simply a job-for-life. No, in our fickle internationalized economy, where many people work six or seven different jobs during the course of their lifetimes, the only ticket that matters is education.

Our K-12 leaders get this, and more and more are stepping up to the challenge. Responding to new data on the critical importance of postsecondary education to future employability, they are aiming to prepare most if not all of their students for college. And nowhere are these efforts more fervent than in the schools with the farthest to go: those serving mostly children from low-income families and children of color.

For the health of both our democracy and our economy, we need these efforts to succeed.

Fortunately, students are responding. More and more are completing advanced college preparatory courses, and college aspirations are steadily rising.[1] While plans for college are increasing among all groups of students, the gains are especially large among minority and low-income students.[2]

Sadly, however, at just the same moment when more low-income and minority youngsters are turning toward college, many colleges are turning away from them.

Nowhere is this turning away more disheartening than in the public flagship universities. The leading, and typically the oldest, four-year institution in each state, the flagships are charged with special responsibilities for producing the future political, business and civic leaders of their respective states.[3]

Public higher education has a rich, proud tradition of serving as an engine of social mobility, and generations of striving Americans have long aspired to attend its institutions. State flagships sit atop this pyramid of opportunity, offering the hope that students from humble origins can learn alongside talented students from all backgrounds. This was America's promise: work hard, excel in school and you, too, could follow your dreams into your state's flagship university.

Over time, however, that compact has been broken, and in its place has come something quite different: the relentless pursuit not of expanded opportunity, but of increased selectivity. Rated less for what they accomplish with the students they let in than by how many students they keep out, many of these flagship institutions have become more and more enclaves for the most privileged of their state's young people.

Even as the number of low-income and minority high school graduates in their states grows, often by leaps and bounds, these institutions are becoming disproportionately whiter and richer.

Why is this happening?

When asked about these trends, campus presidents typically point fingers of blame at "circumstances beyond our control." They point at high schools, for the poor preparation of certain groups of youngsters. At the federal government, for inadequate investments in student aid. And at their respective state governments, for decreasing financial support which makes it necessary for them to raise tuition.

They point fingers everywhere, in other words, except at themselves.

As this fifth report in our series on college results makes clear, however, the univesities themselves are important actors in this drama of shrinking opportunity. Not victims, not sideline spectators, but independent actors.

Yes, there are problems in our high schools. And both the federal and state governments have broken past promises to provide sufficient financial aid to students and adequate support to colleges and universities.

Our nation's 50 flagship universities haven't held up their end of the bargain, either. Most are much wealthier than other public universities and have large endowments. They also typically get more generous funding from their states.

Arguably, the flagships have a lot of money—much of it raised through frequent tuition hikes—to spend on student financial aid. *What these institutions actually spend on financial aid dwarfs the amounts their students receive from either federal or state sources.* In addition, the flagships have virtually unfettered discretion to decide which students will benefit from tuition assistance and how much each student will receive.[4]

Skewed priorities

Flagship universities often justify the size of their tuition increases, at least in part, by the need to provide financial aid to needy students. Yet more and more they aren't spending that money on the low-income students for whom such aid is absolutely essential if they are to attend college, but on the high- income students who will help increase their rankings in college guides.

- In 2003, for example, the flagship universities, along with a group of other public research universities just like them, spent $257 million on financial aid for students from families that earn more than $100,000 per year—considerably more than the $171 million they spent on families at the other end of the economic spectrum who earned less than $20,000 per year.
- In just eight years, spending on aid for these high-income students increased by a whopping $207 million, up from only $50 million in 1995. At the same time, spending on students from families making $40,000 per year or less increased by only $75 million, from $384 to $460 million.
- Astonishingly, the average institutional grant aid to students from families earning over $100,000 annually—$3,823—is actually higher than the average grant awarded to low or middle income students.[5]

The net result of this reshuffling of aid dollars? To meet remaining costs after grant aid, low-income students and their families must come up—from family contributions, work and loans—with amounts the equivalent of 80 percent of their annual incomes. For those at the other end of the spectrum, families making more than $100,000 per year, the amount remaining constitutes a more reasonable 12 percent of their yearly incomes.[6]

Insufficient attention to student success

These and other practices have resulted in entering classes that look less and less like the graduating high school classes in their respective states. But the flagships are even less representative at graduation. For example:

- Though the number of Black, Latino and Native American students entering flagship universities averaged about 24,300 per year between 1997 and 2001, the number of such students graduating each year between 2001 and 2005 averaged only 18,950.
- Across all of the flagships, Black freshmen graduated at only 84 percent, Latino freshmen at 88 percent and Native American freshmen at 61 percent the rate of white students.[7]

All about merit?

Some might say, "Well, what do you expect? These are meritocracies, and not every one has equal merit." Others may say, "The flagships are only supposed to enroll the best and brightest, there are other universities for less talented students."

Well, of course they are meritocratic institutions, and should be. And low-income students, in particular, are underrepresented in the top echelons of high school achievement.

A Closer Look at the Numbers

But, as we show later in this report, there turn out to be far more top-achieving, low-income students who could succeed in these institutions than ever get a chance. Indeed, the highest achieving students from high-income families—those who earned top grades, completed the full battery of college prep courses, and took AP courses as well—are nearly four times more likely than low-income students with exactly the same level of academic accomplishment to end up in a highly selective university.[9]

Where are those talented, low-income students instead? Mostly either not in college at all, or in less selective schools to which these top achieving students could have been admitted if their achievement was only mediocre.

Why? Because what has changed over the past decade in our most prestigious universities is how merit is defined. Now, in addition to academic merit, it appears to help a lot to be wealthy, too.

As a group, the nation's 50 flagship universities are failing to serve the full breadth of their state's populations. They're failing to provide sufficient access and they're failing to focus sufficient energy on student success. That is clear both in their collective grade-point average in the summary sections of this report, and in the fact that "F" was the most common grade earned by the individual flagships on our institutional report card.

Fortunately, however, there are also some "A's"—exceptions that show that flagship universities can indeed do better at both access and success when they really focus. Exceptions that can teach us the way.

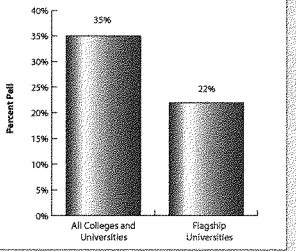
Let's take a closer look at the numbers.

Access for Low-income and Minority Students

In 2005, the nation's 50 flagship universities collectively enrolled approximately 1.2 million undergraduate students—the majority of whom entered these institutions directly after graduating from high school. As a group, however, the undergraduates who attend flagships don't look much like either the high school graduating classes they came from, or college students more generally: they are likely to be more affluent and less racially and ethnically diverse than one might presume.

We know, for example, that 35 percent of American families with children under 18 earn less than $40,000 per year—roughly the threshold for qualifying for a federal Pell Grant.[9] While the data on the income characteristics of students enrolled in flagship universities are limited, we do know that 22 percent of these students receive Pell Grants. This figure not only puts the number of Pell recipients enrolled in flagships below what might be expected given the economic characteristics of society at large, but also well below the 35 percent of such students attending *all* colleges and universities.[10]

Figure 1. Percent of Undergraduates Receiving Pell Grants
by Institutional Type



Compared with other postsecondary institutions, the flagships' combined low-income access ratio

Flagships' Grade for Serving Low-Income Students

(.22) = Pell Grant recipients as % of students in flagships
(.35) = Pell Grant recipients as % of students in all colleges and universities
Low-income access ratio = .63

Flagship Grade: D

Pell Grant

The Pell Grant has long served as the cornerstone of the federal government's financial aid program. Established in 1972 as the Basic Educational Opportunity Grant (BEOG), the Pell Grant has made it possible for millions of students from low-income families to attend two- and four-year colleges. In the 2005-2006 academic year $12.7 billion in Pell Grants were disbursed to over 5 million undergraduate students.[i]

Unlike other forms of financial aid, such as unsubsidized student loans and some scholarships, Pell Grants are awarded solely on the basis of students' income and estimated family contribution (EFC). All students with demonstrated financial need who meet certain residency requirements and enroll in an eligible college or university on at least a part-time basis, qualify to receive the Pell Grant.[ii] In 2004-2005, nearly 60 percent of Pell recipients came from families who earned less than $20,000 per year. The average family income for all Pell recipients was $19, 299.[iii] Most undergraduates who receive the Pell Grant come from families whose earnings place them in the lowest income quartile of all American families.

Over the years, the purchasing power of the Pell Grant has plummeted. In 1979 the maximum Pell award of $1,600 covered 75 percent of the cost of attending a four-year public college or university.by 2005 the maximum award of $4,050 only covered 33 percent of those costs.[iv v] Today, it is estimated that low-income students who wish to attend a four-year public college still face a funding gap (amount between cost of attendance and maximum amount of Pell Grant) of over $6,000.[vi]

Not surprisingly, smaller proportions of low-income students enroll in four-year colleges today than they did 20 or 30 years ago. This enrollment pattern greatly reduces the likelihood that these students will ever earn the bachelor's degrees they hoped to get. Today, 31 percent and 14 percent of Pell Grant recipients enroll in public and private four-year colleges, respectively. Proprietary institutions account for another 18 percent of Pell recipients, while the greatest share, 36 percent, enroll in two-year institutions.[vii]

[i] Sandy Baum and Kathleen Payea (2006). *Trends in Student Aid 2006*.Washington, DC:The College Board.

[ii] NCES (2006). *2004-2005 Federal Pell Grant Program End-of-Year Report*. Washington, DC:U.S. Department of Education.

[iii] Ibid.

[iv] American Council on Education (2004). *ACE Fact Sheet on Higher Education*. Washington, DC:American Council on Education.

[v] Sandy Baum and Kathleen Payea (2006). *Trends in Student Aid 2006*.Washington, DC:The College Board.

[vi] Edward P.St. John (2005). *Affordability of Postsecondary Education: Equity and Adequacy Across the 50 States*. Washington, DC:The Center for American Progress.

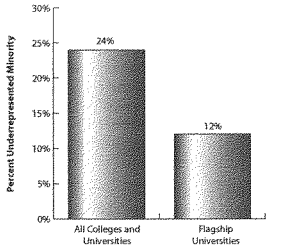
[vii] NCES (2006). *2004-2005 Federal Pell Grant Program End-of-Year Report*. Washington, DC:U.S. Department of Education.

of .63 (calculated by dividing the 22 percent of Pell recipients enrolled at flagships by the 35 percent of Pell recipients enrolled at all colleges and universities) suggests that they are serving approximately one-third less than what might be considered their fair share of all low-income college students. On a typical classroom grading scale, then, that 63 percent would earn the flagships a "D" for providing access to low-income students.

Flagship enrollment patterns by race look even worse than the low-income numbers. Together, African Americans, Latinos and Native Americans—groups that have traditionally been underrepresented in higher education—account for approximately 12 percent of undergraduate students at flagship universities. This figure is much lower, however, than either the percentage of high school graduates from these same groups over the last five years (approximately 26 percent)[11] or their share of all undergraduate student enrollments (approximately 24 percent).[12]

In 2004, minority students accounted for 28 percent of the nation's high school graduates and 12 percent of freshmen enrolled at the flagships. This results in the flagships' minority access ratio of .43 (.12 ÷.28 = .43), which makes it clear that these institutions are only serving about half of what might be considered their fair share of minority students. By this measure, the nation's flagships get an "F" on a typical grading scale for facilitating access for minority students.

Figure 2. Percent of Students Who Are Black, Latino, or Native American
by Institutional Type



Flagships' Grade for Serving African American, Latino and Native American Students

(.12) = % of AA, Latino and NA freshmen at flagships
(.28) = % of AA, Latino and NA high school graduates
Minority access ratio = **.43**

Flagship Grade: F

What are the Trends?

Even in the face of such disproportionate underrepresentation of low-income and minority students at the flagships, Americans might be willing to be patient if these institutions were making steady progress in better serving the vast breadth of our citizenry. Available evidence, however, suggests just the opposite.

Low-Income Student Access Trend

1992: **.24** = Pell Grant recipients as % of 1992 undergrads. at flagships / **.29** = Pell Grant recipients as % of 1992 undergrads. at all colleges & universities = **.83**

2003: **.22** = Pell Grant recipients as % of 2003 undergrads. at flagships / **.35** = Pell Grant recipients as % of 2003 undergrads. at all colleges & universities = **.63**

Overall Trend: ♣
The representation of low-income students at the flagships decreased from .83 to .63.

According to national Pell recipient data, above, the absolute number and proportion of students receiving Pell Grants has increased over the past 11 years, up from 29 percent of all undergraduates in 1992 to 35 percent by 2003. Over this same period, however, the percentage of Pell recipients in flagship universities declined from 24 percent in 1992 to 22 percent in 2003.[13]

Minority Student Access Trend

1992: **.11** = minority students as % of 1992 freshmen at flagships / **.22** = minority students as % of 1992 high school graduates nationwide = **.50**

2004: **.12** = minority students as % of 2004 freshmen at flagships / **.28** = minority students as % of 2004 high school graduates nationwide = **.43**

Overall Trend: ♣
The representation of minority students at the flagships decreased from .50 to .43.

At first glance (preceeding box), the over-time enrollment numbers for students of color at flagships seem to be improving, at least a little bit. Together, Black, Latino and Native American students grew from 11 percent of freshmen enrolled in flagships in 1992 to 12 percent by 2004.[14] But it turns out that these enrollment increases were swamped by even larger gains in the number of such students graduating from high school. The result is that these schools have become much less representative of the racial composition of the nation's high school graduates.

In other words, the 50 flagship universities now look less and less like America—and more and more like "gated communities of higher education."[15]

Success Rates for the Low-income and Minority Students Who DO Enroll in Flagship Universities

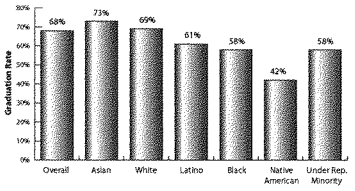
Because the federal government doesn't collect the necessary data, we don't have any information on the graduation rates of low-income students who enroll in college. As a group, therefore, we have to assign the flagships a grade of "Incomplete" for success in graduating low-income students.

However, because data on success rates by race are both collected and reported, we can examine how freshmen from different groups fare in terms of receiving bachelor's degrees within six years of entering the flagships.

Graduation data for the flagships as a whole appear in Table 3 below. When compared to most other colleges, the flagships tend to do a better job of graduating their students within six years. Yet, a close look at the graduation rates reveals that these institutions have sizable gaps between the rates at which different groups of students earn the degrees they aspired to get. Among Asian and White freshmen, for instance, a full 73 percent and 69 percent, respectively, get out with degrees within six years. The numbers are very different for Latinos (61 percent), Blacks (58 percent) and Native Americans (42 percent).

All together, minority freshmen graduate at approximately 84 percent of the rate of their White counterparts, meriting the flagships a grade of "B" on this indicator.

Figure 3. Graduation Rates at Flagships
by Race/Ethnicity



Flagships' Grade for Student Success—Graduation Rate Gaps
(.58) = six-year graduation rate for AA, Latino and NA freshmen at flagships / (.69) = six-year graduation rate for White freshmen at flagships
Student Success Ratio = **.84**
Flagship Grade: B

What seems clear, then, is that the flagships as a group are better at ensuring that the students they do admit successfully graduate, than they are at creating opportunities for more poor students and students of color to have access to these institutions in the first place.

But even so, the combined effects of gaps in both access and success are evident—even when we add in transfers from community colleges. African-Americans, Latinos and Native Americans comprised only 10 percent of flagship graduates in 2005. By contrast, they accounted for 25 percent of the nation's high school graduate population four years earlier.[16]

Grading the Individual Flagships

Most of the existing measures used to rate American colleges and universities focus on status and selectivity rather than access and success. Accordingly, to help readers evaluate how well the flagship in their own state is serving the high school graduates in that state, we have created (or, in a few cases, borrowed) a set of metrics and applied them to each flagship.[17] Then, for clarity's sake, we've assigned a letter grade to each. Also, where historical data are available, we look at trends in access and success and show whether the institution is getting better—or getting worse.

Though flagship universities have much in common, especially in the unique roles they play and the respect that they receive within their respective states, they also differ in many ways. Some, it turns out, are far more successful than others in enrolling low-income and minority students, while others have far more success in graduating them.

To be sure, there are important contextual characteristics—in the selectivity of these institutions, in the nature of the state populations from which they draw the majority of their students, and the like—that may render their ability to perform well on these access and success measures harder or easier. One might expect, for example, that public universities in Alabama and Georgia will enroll significantly more African-American students than their counterparts in New Hampshire or South Dakota.

Before we get to the report card it's important to note that we have made no attempt to assess institutional quality. These grades are not intended to judge the overall excellence of these institutions. *Our grades are designed solely to evaluate the degree to which the flagships are equitably serving the minority and low-income students in their states.*

What do the grades look like?

Given the overall patterns described earlier, which show that the flagship institutions as a group don't even come close to adequately reflecting the populations of their states, it won't be surprising that "F" was the most common grade assigned to these institutions. Indeed, of the 200 grades in the Flagship Report Card on page 10, more than one-third were "F's."

But, before we go any further, it is important to explain how the grades were calculated, so that readers can understand the importance of and differences among each of the individual indicators.

Our report card contains seven separate indices, three of which look at current results, three which measure trends over time and one cumulative grade. The three indicators that measure the current status of access and success, along with the cumulative measure which is an average of the first three, are graded. We award A's for 90 percent or better; B's for 80-89 percent, C's for 70-79 percent, D's for 60-69 percent, and F's for everything below that. The trend measures are scored even more simply, with up and down arrows to indicate improvements or declines over time.

We also assigned each flagship a cumulative grade, the most common of which were D's and F's. No flagship received an overall grade of "A," and only four earned "B's."

The grades and trends highlighted in this report card paint a grim picture. Clearly, the accessibility of these institutions is declining; success rates for minority students are lagging, and most institutions are getting worse, not better.

No matter how you look at it, our nation's flagships are not equitably serving a large proportion of our young people. This, undoubtedly, has devastating implications for our nation's future.

GRADE 1: Access for African-American, Latino and Native American students

What

We compare the percentage of African-American, Latino and Native American freshmen enrolled at each of the flagships in the fall of 2004 to the percentage of these students among 2004 high school graduates in each respective state.

Examples

At the University of Georgia (UGA), only seven percent of freshmen were African American, Latino or Native American, but these students accounted for 36 percent of Georgia's 2004 high school graduates. Therefore, UGA's access ratio for minority students is .19, the lowest of all 50 flagships, and the institution received a grade of "F" on this measure.

The University of Minnesota did much better. Together, African American, Latino and Native Americans represented exactly 7.7 percent of the freshmen class and exactly 7.7 percent of the state's high school graduates. The University of Minnesota's ratio of minority freshmen to Minnesota's minority high school graduates was 1.0 and resulted in the university receiving an "A" for providing access to minority students.

Grade Distribution

Overall, 27 of the 50 flagships received "F's" on this access index. Only 6 received A's.

Grade 2: Progress in Access for African-American, Latino and Native American Students

What

We compare the percentage of minority freshmen enrolled at each flagship in 1992 to the percentage of minority high school graduates in each respective state in 1992. We calculate the same measure for 2004 and then compare the 1992 and 2004 ratios.

Examples

The representation of New Mexico's minority high school graduates among the University of New Mexico's freshmen class increased from .70 to .85. On the other hand, the representation of Illinois' minority high school graduates among freshmen at the University of Illinois, Urbana-Champaign decreased from .73 to .48.

Grade Distribution

Of all 50 flagships, 15 made positive gains on this measure and 35 experienced declines.

Grade 3: Access for Low-Income Students

What

We use a the Pell Grant as a proxy for low-income status and compare the percentage of Pell Grant recipients enrolled at each flagship in 2004 to the percentage of Pell Grant recipients enrolled at all colleges and universities in that state in 2004.

Examples

At the University of California-Berkeley, 34 percent of undergraduates receive the Pell Grant, but in the state of California as a whole, only 29 percent of undergraduates are Pell recipients. UC-Berkeley's low-income access index is 1.17 and its grade on this measure is an "A."

Only 19 percent of students attending Louisiana State University (LSU) receive Pell Grants, compared to 48 percent of college students statewide. LSU's low-income access ratio is .40, warranting a grade of "F" on this indicator.

Grade Distribution

Seven flagships received A's for equitably serving their state's low-income students; 26 received F's.

Grade 4: Progress in Access for Low-Income Students

What

We compare the percentage of Pell recipients enrolled at each flagship in 1992 to the percentage of Pell recipients in all colleges and universities in each respective state in 1992. We then calculate the same measure for 2004 and compare the 1992 and 2004 ratios.

Examples

The representation of low-income students enrolled at the University of Vermont relative to low-income students enrolled at all other colleges throughout the state increased from .49 to .61. Using the same calculation, representation of low-income students at the University of Oklahoma decreased from .93 to .58.

Grade Distribution

Six flagships made progress in providing access for low-income students; 44 actually got worse.

Grade 5: Student Success

What

We grade the flagships on their six-year graduation rate for minority students relative to their six-year graduation rate for White students. Schools with small or no gaps between the rates at which their minority and White students graduate receive higher grades.

Examples

At Ohio State University the combined six-year graduation rate for African-American, Latino and Native American students is 56 percent, compared to a six-year graduation rate of 69 percent for White students. This 13-point gap results in minority students graduating at 81 percent the rate of their White peers and earns a grade of "B" for Ohio State.

The State University of New York at Buffalo has six-year graduation rates of 41 percent for minority students and 62 percent for White students. This 21-point gap means that minority students graduate 66 percent the rate of their White peers and results in a success grade of "D" for New York's flagship.

Grade Distribution

Eight flagships earned "A's" for having small graduation rate gaps, three earned "F's."

Grade 6: Change in access and success of minority students, 1986-2005

What

We measure the extent to which the flagships are making progress on both the access and success fronts for underrepresented students. Unlike other measures this one picks up students who transfer in from community colleges or other universities. The first ratio compares the proportion of degrees that were conferred at each of the flagships in 1990 to the percentage of that state's minority high school graduates four years earlier. The second ratio compares the percentage of degrees conferred to minority students at each individual flagship in 2005 to the percentage of minority high school graduates in each state four years earlier. We then compare the two ratios.

Examples

The proportion of degrees conferred to minority students at Ohio State University relative to the state's minority high school increased from a ratio of .32 to .82. The corresponding ratio at the University of California-Berkeley decreased from .50 to .36.

Grade Distribution

Thirty-nine of the 50 flagships made favorable progress on this measure and 11 got worse.

Flagship Report Card: Grades

		Grade 1	Grade 2	Grade 3	Grade 4	Grade 5		Grade 6	
Institution Name	State	Minority Access	Progress in Minority Access	Low - Income Access	Progress in Low - Income Access	Minority Success	Pell Success	Progress in Access and Success	Overall Grade
U. OF ALASKA FAIRBANKS	AK	A	↑	A	↓	F	Data Not Collected By USDOE	↑	C
U. OF ALABAMA	AL	F	↓	F	↓	A		↑	D
U. OF ARKANSAS AT FAYETTEVILLE	AR	F	↓	F	↓	C		↑	F
U. OF ARIZONA	AZ	F	↓	F	↓	C		↑	F
U. OF CALIFORNIA-BERKELEY	CA	F	↓	A	↓	B		↓	C
U. OF COLORADO AT BOULDER	CO	F	↓	F	↓	B		↑	D
U. OF CONNECTICUT	CT	F	↓	F	↓	B		↑	D
U. OF DELAWARE	DE	F	↑	F	↑	B		↑	D
U. OF FLORIDA	FL	D	↑	F	↓	B		↑	D
U. OF GEORGIA	GA	F	↓	F	↓	A		↑	D
U. OF HAWAII AT MANOA	HI	D	↑	A	↑	A		↓	B
U. OF IOWA	IA	B	↓	F	↓	C		↓	D
U. OF IDAHO	ID	B	↓	C	↓	C		↓	C
U. OF ILLINOIS AT URBANA-CHAMPAIGN	IL	F	↓	F	↓	C		↑	F
INDIANA U.-BLOOMINGTON	IN	C	↑	F	↓	C		↑	D
U. OF KANSAS	KS	D	↑	F	↓	C		↑	D
U. OF KENTUCKY	KY	C	↓	A	↑	C		↑	C
LOUISIANA STATE U.	LA	F	↓	F	↓	A		↑	D
UMASS AMHERST	MA	F	↓	A	↓	B		↓	C
U. OF MARYLAND COLLEGE PARK	MD	F	↓	D	↓	B		↑	D
U. OF MAINE	ME	A	↓	B	↓	D		↑	C
U. OF MICHIGAN-ANN ARBOR	MI	B	↓	F	↓	B		↑	C
U. OF MINNESOTA TWIN CITIES	MN	A	↓	D	↑	D		↓	C
U. OF MISSOURI-COLUMBIA	MO	F	↑	F	↓	B		↑	D
U. OF MISSISSIPPI	MS	F	↑	F	↓	C		↑	F
U. OF MONTANA	MT	D	↓	A	↓	D		↓	C
UNC CHAPEL HILL	NC	F	↑	F	↓	B		↑	D
U. OF NORTH DAKOTA	ND	F	↓	C	↓	F		↓	F
U. OF NEBRASKA AT LINCOLN	NE	F	↓	C	↓	D		↑	D
U. OF NEW HAMPSHIRE	NH	A	↑	D	↓	A		↓	B
RUTGERS U. -NEW BRUNSWICK	NJ	D	↓	B	↓	B		↑	C
U. OF NEW MEXICO	NM	B	↑	B	↓	B		↑	B
U. OF NEVADA-RENO	NV	F	↑	C	↓	B		↑	D
SUNY AT BUFFALO	NY	F	↓	A	↑	D		↑	D
OHIO STATE U.	OH	C	↓	D	↓	B		↑	C
U. OF OKLAHOMA NORMAN CAMPUS	OK	F	↓	F	↓	B		↑	D
U. OF OREGON	OR	F	↓	D	↓	C		↑	D
PENN STATE U.	PA	F	↑	F	↓	C		↑	F
U. OF RHODE ISLAND	RI	F	↓	F	↓	C		↑	F
U. OF SOUTH CAROLINA AT COLUMBIA	SC	F	↓	F	↓	B		↑	D
U. OF SOUTH DAKOTA	SD	D	↓	C	↓	F		↑	D
U. OF TENNESSEE-KNOXVILLE	TN	F	↑	F	↓	A		↑	D
U. OF TEXAS AT AUSTIN	TX	F	↓	F	↓	B		↑	D
U. OF UTAH	UT	B	↓	C	↓	B		↓	C
U. OF VIRGINIA	VA	F	↓	F	↓	A		↑	D
U. OF VERMONT	VT	A	↑	D	↑	A		↑	B
U. OF WASHINGTON	WA	D	↓	C	↓	B		↓	C
U. OF WISCONSIN-MADISON	WI	C	↓	F	↓	C		↓	D
WEST VIRGINIA U.	WV	A	↓	F	↓	D		↓	D
U. OF WYOMING	WY	C	↓	B	↓	B		↓	C

		Grade 1: Minority Access				Grade 2: Progress in Minority Access				
		1	2	3	4	5	6	7	8	9
Institution Name	State	Spring '04 HS grads,URM %	Fall '04 freshmen,URM %	Ratio '04	Minority Access Grade	Spring '92 HS grads, URM %	Fall '92 freshmen, URM %	Ratio '92	Ratio % change, '92-'04	Progress in Minority Access '92-'04
U. OF ALASKA FAIRBANKS	AK	24.9%	29.8%	1.20	A	24.5%	23.7%	0.97	23.6%	↑
U. OF ALABAMA	AL	33.3%	11.0%	0.33	F	32.4%	12.7%	0.39	-15.8%	↓
U. OF ARKANSAS AT FAYETTEVILLE	AR	24.1%	9.4%	0.39	F	21.9%	8.7%	0.40	-1.7%	↓
U. OF ARIZONA	AZ	41.0%	21.0%	0.51	F	30.8%	17.0%	0.55	-7.1%	↓
U. OF CALIFORNIA-BERKELEY	CA	44.0%	15.9%	0.32	F	35.1%	23.9%	0.68	-53.6%	↓
U. OF COLORADO AT BOULDER	CO	21.9%	9.2%	0.42	F	18.0%	10.4%	0.58	-27.1%	↓
U. OF CONNECTICUT	CT	21.2%	11.1%	0.52	F	16.7%	9.3%	0.56	-6.7%	↓
U. OF DELAWARE	DE	31.3%	11.1%	0.35	F	23.9%	5.3%	0.22	60.0%	↑
U. OF FLORIDA	FL	38.6%	23.1%	0.60	D	33.2%	17.1%	0.51	18.3%	↑
U. OF GEORGIA	GA	35.8%	6.8%	0.19	F	35.0%	11.7%	0.33	-43.2%	↓
U. OF HAWAII AT MANOA	HI	6.4%	4.0%	0.62	D	7.5%	1.1%	0.15	324.0%	↑
U. OF IOWA	IA	5.7%	5.0%	0.88	B	3.5%	4.5%	1.30	-32.1%	↓
U. OF IDAHO	ID	9.2%	7.7%	0.83	B	4.9%	4.2%	0.84	-11.4%	↓
U. OF ILLINOIS AT URBANA-CHAMPAIGN	IL	26.6%	12.8%	0.48	F	22.7%	16.5%	0.73	-33.9%	↓
INDIANA U. BLOOMINGTON	IN	10.8%	8.3%	0.77	C	10.7%	7.4%	0.69	10.5%	↑
U. OF KANSAS	KS	14.4%	9.5%	0.66	D	10.4%	6.2%	0.59	10.8%	↑
U. OF KENTUCKY	KY	10.7%	7.8%	0.73	C	8.6%	6.6%	0.77	4.8%	↑
LOUISIANA STATE U.	LA	42.2%	12.5%	0.30	F	39.1%	11.6%	0.30	-0.1%	↓
UMASS AMHERST	MA	16.3%	8.1%	0.53	F	11.3%	7.9%	0.70	-24.4%	↓
U. OF MARYLAND COLLEGE PARK	MD	36.7%	19.7%	0.54	F	29.3%	17.0%	0.58	-7.5%	↓
U. OF MAINE	ME	2.4%	3.2%	1.33	A	1.4%	11.9%	8.41	-84.2%	↓
U. OF MICHIGAN-ANN ARBOR	MI	15.2%	12.2%	0.80	B	14.9%	16.1%	1.08	-25.5%	↓
U. OF MINNESOTA TWIN CITIES	MN	7.7%	7.7%	1.00	A	4.0%	9.2%	2.29	-56.3%	↓
U. OF MISSOURI-COLUMBIA	MO	15.5%	8.9%	0.57	F	14.7%	6.5%	0.44	30.0%	↑
U. OF MISSISSIPPI	MS	47.0%	12.0%	0.26	F	46.6%	8.9%	0.19	33.6%	↑
U. OF MONTANA	MT	9.1%	6.5%	0.60	D	7.7%	5.4%	0.70	-14.4%	↓
UNC-CHAPEL HILL	NC	31.6%	16.0%	0.51	F	30.1%	12.4%	0.41	22.7%	↑
U. OF NORTH DAKOTA	ND	7.2%	3.5%	0.49	F	5.8%	4.1%	0.71	-31.4%	↓
U. OF NEBRASKA AT LINCOLN	NE	10.7%	6.3%	0.59	F	6.4%	4.4%	0.69	-14.6%	↓
U. OF NEW HAMPSHIRE	NH	3.0%	3.9%	1.32	A	2.3%	1.9%	0.83	58.4%	↑
RUTGERS U., NEW BRUNSWICK	NJ	29.2%	19.1%	0.65	D	23.2%	19.7%	0.85	-22.7%	↓
U. OF NEW MEXICO	NM	58.2%	49.8%	0.85	B	54.2%	38.0%	0.70	21.9%	↑
U. OF NEVADA-RENO	NV	26.4%	12.3%	0.47	F	18.8%	7.0%	0.37	25.4%	↑
SUNY AT BUFFALO	NY	25.7%	12.3%	0.48	F	22.9%	13.7%	0.60	-19.9%	↓
OHIO STATE U.	OH	13.5%	9.9%	0.74	C	10.6%	10.2%	0.97	-23.9%	↓
U. OF OKLAHOMA NORMAN CAMPUS	OK	31.0%	15.6%	0.50	F	21.7%	20.4%	0.94	-46.8%	↓
U. OF OREGON	OR	11.9%	6.4%	0.54	F	6.0%	8.1%	1.02	-47.3%	↓
PENN STATE U.	PA	15.0%	8.2%	0.55	F	10.5%	5.7%	0.54	0.8%	↑
U. OF RHODE ISLAND	RI	17.6%	10.0%	0.57	F	5.3%	6.1%	1.15	-50.7%	↓
U. OF SOUTH CAROLINA AT COLUMBIA	SC	40.6%	15.7%	0.39	F	38.7%	20.1%	0.52	-25.7%	↓
U. OF SOUTH DAKOTA	SD	8.9%	4.2%	0.61	D	5.4%	5.0%	0.93	-34.3%	↓
U. OF TENNESSEE-KNOXVILLE	TN	21.7%	11.9%	0.55	F	18.4%	7.8%	0.42	29.6%	↑
U. OF TEXAS AT AUSTIN	TX	48.9%	21.9%	0.45	F	40.7%	19.2%	0.47	-5.1%	↓
U. OF UTAH	UT	8.0%	6.5%	0.81	B	4.6%	4.4%	0.95	-14.9%	↓
U. OF VIRGINIA	VA	27.7%	15.0%	0.54	F	22.1%	15.2%	0.69	-21.4%	↓
U. OF VERMONT	VT	2.7%	3.6%	1.33	A	1.7%	1.8%	1.06	25.5%	↑
U. OF WASHINGTON	WA	13.8%	9.5%	0.69	D	8.8%	7.8%	0.88	-22.2%	↓
U. OF WISCONSIN-MADISON	WI	9.3%	6.8%	0.74	C	6.5%	4.8%	0.74	-0.5%	↓
WEST VIRGINIA U.	WV	4.2%	4.7%	1.12	A	3.5%	5.0%	1.41	-20.7%	↓
U. OF WYOMING	WY	7.8%	5.9%	0.76	C	8.4%	6.7%	0.80	-5.1%	↓

Note: URM = underrepresented minority and comprises African-American, Latino, and Native-American. Column 3 (Ratio '04) = Column 2 / Column 1. Column 7 (Ratio '92) = Column 6 / Column 5. Column 8 (Ratio % Change '92 - '04) = ((Column 3 - Column 7)/Column 7). The numbers that appear in columns 1-3, and 5-8 are rounded, but the numbers used to generate columns 3, 7, and 8 are not so calculating the values for columns 3, 7, and 8 using the numbers in the chart may yield results slightly different from the numbers that appear in columns 1, 7, and 8.

		Grade 3: Low-Income Access				Grade 4: Progress in Low-Income Access				
		1	2	3	4	5	6	7	8	9
Institution Name	State	Flagship studs with Pell '04 %	State studs with Pell '04 %	Equity index '04	Low - income Access Grade	Flagship studs with Pell '92 %	State studs with Pell '92 %	Equity Index '92	Equity Index % change	Progress in Low-Income Access '92 - '04
U. OF ALASKA FAIRBANKS	AK	17.9%	17.7%	1.01	A	17.2%	13.5%	1.27	-20.7%	↓
U. OF ALABAMA	AL	23.6%	50.4%	0.47	F	23.0%	38.1%	0.60	-22.4%	↓
U. OF ARKANSAS AT FAYETTEVILLE	AR	23.7%	48.3%	0.49	F	29.2%	39.9%	0.73	-32.7%	↓
U. OF ARIZONA	AZ	24.5%	41.9%	0.59	F	23.9%	27.1%	0.88	-33.6%	↓
U. OF CALIFORNIA-BERKELEY	CA	33.6%	28.7%	1.17	A	27.0%	19.8%	1.36	-14.2%	↓
U. OF COLORADO AT BOULDER	CO	14.5%	34.5%	0.42	F	17.8%	25.3%	0.70	-40.4%	↓
U. OF CONNECTICUT	CT	18.3%	26.0%	0.69	F	11.8%	16.4%	0.72	-18.1%	↓
U. OF DELAWARE	DE	9.8%	24.4%	0.40	F	6.7%	17.2%	0.39	4.0%	↑
U. OF FLORIDA	FL	23.9%	40.2%	0.59	F	24.3%	26.5%	0.92	-35.4%	↓
U. OF GEORGIA	GA	13.9%	48.5%	0.29	F	15.9%	33.1%	0.48	-40.6%	↓
U. OF HAWAII AT MANOA	HI	21.1%	22.5%	0.94	A	10.6%	12.5%	0.85	9.8%	↑
U. OF IOWA	IA	17.7%	39.9%	0.44	F	20.4%	35.3%	0.58	-22.9%	↓
U. OF IDAHO	ID	37.0%	47.4%	0.78	C	33.4%	39.7%	0.84	-7.3%	↓
U. OF ILLINOIS AT URBANA--CHAMPAIGN	IL	16.3%	32.3%	0.51	F	19.8%	26.3%	0.76	-35.5%	↓
INDIANA U.--BLOOMINGTON	IN	16.5%	44.7%	0.37	F	18.7%	34.2%	0.55	-32.4%	↓
U. OF KANSAS	KS	15.6%	31.6%	0.49	F	20.3%	29.7%	0.68	-27.7%	↓
U. OF KENTUCKY	KY	37.3%	41.2%	0.91	A	36.4%	47.0%	0.78	16.8%	↑
LOUISIANA STATE U.	LA	19.2%	47.8%	0.40	F	21.6%	42.2%	0.51	-21.5%	↓
UMASS AMHERST	MA	23.4%	24.0%	0.97	A	21.6%	22.1%	0.98	-0.7%	↓
U. OF MARYLAND COLLEGE PARK	MD	16.9%	28.3%	0.60	D	16.2%	21.0%	0.77	-22.3%	↓
U. OF MAINE	ME	30.4%	34.0%	0.89	B	29.0%	27.0%	1.08	-16.9%	↓
U. OF MICHIGAN-ANN ARBOR	MI	13.5%	33.9%	0.40	F	14.9%	30.6%	0.49	-18.2%	↓
U. OF MINNESOTA TWIN CITIES	MN	18.1%	28.4%	0.64	D	19.7%	32.2%	0.61	4.0%	↑
U. OF MISSOURI-COLUMBIA	MO	16.6%	38.3%	0.43	F	24.8%	33.4%	0.74	-41.8%	↓
U. OF MISSISSIPPI	MS	25.1%	59.8%	0.43	F	25.6%	49.1%	0.52	-18.2%	↓
U. OF MONTANA	MT	38.8%	42.7%	0.91	A	39.9%	43.7%	0.91	-0.4%	↓
UNC CHAPEL HILL	NC	14.7%	35.9%	0.41	F	14.6%	23.2%	0.63	-35.0%	↓
U. OF NORTH DAKOTA	ND	24.9%	33.7%	0.74	C	33.4%	43.7%	0.77	-3.6%	↓
U. OF NEBRASKA AT LINCOLN	NE	21.6%	30.1%	0.72	C	27.4%	31.0%	0.88	-18.5%	↓
U. OF NEW HAMPSHIRE	NH	16.2%	24.8%	0.65	D	18.5%	20.6%	0.90	-27.3%	↓
RUTGERS U.-NEW BRUNSWICK	NJ	27.8%	31.7%	0.88	B	21.0%	21.9%	0.96	-8.3%	↓
U. OF NEW MEXICO	NM	33.5%	40.2%	0.83	B	36.4%	36.6%	0.99	-16.1%	↓
U. OF NEVADA RENO	NV	14.5%	20.6%	0.72	C	14.3%	14.8%	0.97	-25.1%	↓
SUNY AT BUFFALO	NY	37.5%	40.9%	0.92	A	28.4%	37.2%	0.76	20.3%	↑
OHIO STATE U.	OH	23.0%	38.6%	0.60	D	22.2%	32.9%	0.68	-11.8%	↓
U. OF OKLAHOMA NORMAN CAMPUS	OK	24.4%	42.2%	0.58	F	33.2%	35.6%	0.93	-37.9%	↓
U. OF OREGON	OR	25.4%	37.4%	0.68	D	24.3%	28.6%	0.85	-20.2%	↓
PENN STATE U.	PA	18.0%	33.6%	0.54	F	22.2%	27.7%	0.80	-33.2%	↓
U. OF RHODE ISLAND	RI	20.8%	35.2%	0.59	F	18.8%	23.2%	0.81	-27.0%	↓
U. OF SOUTH CAROLINA AT COLUMBIA	SC	23.6%	44.1%	0.54	F	26.0%	32.7%	0.79	-32.7%	↓
U. OF SOUTH DAKOTA	SD	32.0%	43.4%	0.74	C	41.5%	46.4%	0.89	-17.4%	↓
U. OF TENNESSEE-KNOXVILLE	TN	22.6%	43.3%	0.52	F	22.0%	31.2%	0.71	-26.1%	↓
U. OF TEXAS AT AUSTIN	TX	21.4%	43.2%	0.50	F	19.3%	28.5%	0.68	-27.0%	↓
U. OF UTAH	UT	28.0%	38.0%	0.74	C	30.1%	39.2%	0.77	-4.1%	↓
U. OF VIRGINIA	VA	7.6%	28.7%	0.26	F	9.9%	23.0%	0.43	-38.9%	↓
U. OF VERMONT	VT	17.0%	28.0%	0.61	D	12.9%	26.3%	0.49	23.6%	↑
U. OF WASHINGTON	WA	22.5%	29.8%	0.75	C	19.3%	24.7%	0.78	-3.2%	↓
U. OF WISCONSIN-MADISON	WI	13.1%	24.2%	0.54	F	16.4%	26.0%	0.63	-13.8%	↓
WEST VIRGINIA U.	WV	27.0%	49.3%	0.55	F	23.6%	34.1%	0.69	-20.7%	↓
U. OF WYOMING	WY	26.5%	31.0%	0.86	B	33.1%	32.1%	1.03	-16.8%	↓

Note: Column 3 (Equity Index '94-'05) = Column 1 / Column 2. Column 7 (Equity Index '92) = Column 5 / Column 6. Column 8 (Equity Index % Change) = ((Column 3 - Column 7)/Column 7). Kentucky pell grant data, both statewide and flagship data, are from 2003. The numbers that appear in columns 1-3 and 5-8 are rounded, but the numbers used to generate columns 3, 7, and 8 are not, so calculating the values for columns 3, 7, and 8 using the numbers in the chart may yield results slightly different from the numbers that appear in columns 3, 7, and 8.

		Grade 5: Minority Student Success					
		1	2	3	4	5	6
Institution Name	State	Overall Six-Year Grad Rate	White Grad Rate	URM Grad Rate	URM-White gap	URM-White Grad Rate Equity Score	Minority Success Grade
U. OF ALASKA FAIRBANKS	AK	21.6%	25.4%	9.6%	15.8	37.8%	F
U. OF ALABAMA	AL	62.9%	63.6%	58.6%	5	92.1%	A
U. OF ARKANSAS AT FAYETTEVILLE	AR	56.4%	57.8%	45.6%	12	79.2%	C
U. OF ARIZONA	AZ	58.9%	61.2%	46.7%	14.5	76.3%	C
U. OF CALIFORNIA-BERKELEY	CA	87.1%	86.6%	74.4%	12.2	85.9%	B
U. OF COLORADO AT BOULDER	CO	66.2%	67.3%	57.8%	9.5	85.9%	B
U. OF CONNECTICUT	CT	71.7%	72.8%	63.2%	9.6	86.8%	B
U. OF DELAWARE	DE	76.4%	77.5%	65.3%	12.2	84.3%	B
U. OF FLORIDA	FL	79.3%	81.1%	72.7%	8.4	89.6%	B
U. OF GEORGIA	GA	73.2%	73.9%	68.9%	5	93.2%	A
U. OF HAWAII AT MANOA	HI	51.1%	28.1%	34.6%	-6.5	123.1%	A
U. OF IOWA	IA	66.1%	67.3%	51.5%	15.8	76.5%	C
U. OF IDAHO	ID	57.4%	57.6%	43.8%	13.8	76.0%	C
U. OF ILLINOIS AT URBANA-CHAMPAIGN	IL	82.9%	86.0%	65.7%	20.3	76.4%	C
INDIANA U.-BLOOMINGTON	IN	71.7%	73.2%	53.8%	19.4	73.5%	C
U. OF KANSAS	KS	59.3%	60.7%	45.3%	15.4	74.6%	C
U. OF KENTUCKY	KY	59.8%	60.8%	46.4%	14.4	76.3%	C
LOUISIANA STATE U.	LA	56.8%	57.9%	52.2%	5.7	90.2%	A
UMASS AMHERST	MA	65.7%	67.5%	57.2%	10.3	84.7%	B
U. OF MARYLAND COLLEGE PARK	MD	76.5%	79.8%	66.8%	13	83.7%	B
U. OF MAINE	ME	52.7%	53.6%	37.0%	16.6	69.0%	D
U. OF MICHIGAN-ANN ARBOR	MI	86.5%	92.0%	74.9%	17.1	81.4%	B
U. OF MINNESOTA TWIN CITIES	MN	60.7%	63.7%	41.4%	22.3	65.0%	D
U. OF MISSOURI-COLUMBIA	MO	66.0%	67.0%	58.6%	8.4	87.5%	B
U. OF MISSISSIPPI	MS	56.2%	58.1%	44.2%	13.9	76.1%	C
U. OF MONTANA	MT	43.9%	44.4%	29.4%	15	66.2%	D
UNC CHAPEL HILL	NC	83.8%	85.2%	75.9%	9.3	89.1%	B
U. OF NORTH DAKOTA	ND	56.1%	57.1%	26.5%	30.6	46.4%	F
U. OF NEBRASKA AT LINCOLN	NE	63.4%	64.6%	42.4%	22.2	65.6%	D
U. OF NEW HAMPSHIRE	NH	73.1%	74.4%	69.0%	5.4	92.7%	A
RUTGERS U.-NEW BRUNSWICK	NJ	71.3%	71.9%	62.5%	9.4	86.9%	B
U. OF NEW MEXICO	NM	40.7%	44.3%	36.9%	7.4	83.3%	B
U. OF NEVADA-RENO	NV	51.7%	52.0%	41.7%	10.3	80.2%	B
SUNY AT BUFFALO	NY	58.8%	61.7%	41.1%	20.6	66.6%	D
OHIO STATE U.	OH	68.2%	69.4%	56.2%	13.2	81.0%	B
U. OF OKLAHOMA NORMAN CAMPUS	OK	54.9%	56.8%	46.7%	10.1	82.2%	B
U. OF OREGON	OR	63.0%	63.5%	47.0%	16.5	74.0%	C
PENN STATE U.	PA	84.2%	86.1%	68.8%	17.3	79.9%	C
U. OF RHODE ISLAND	RI	55.8%	57.9%	43.5%	14.4	75.1%	C
U. OF SOUTH CAROLINA AT COLUMBIA	SC	64.9%	66.6%	59.0%	7.6	88.6%	B
U. OF SOUTH DAKOTA	SD	46.4%	49.1%	9.4%	39.7	19.1%	F
U. OF TENNESSEE-KNOXVILLE	TN	57.2%	57.6%	54.5%	3.1	94.6%	A
U. OF TEXAS AT AUSTIN	TX	75.1%	76.3%	67.5%	8	88.2%	B
U. OF UTAH	UT	43.1%	41.2%	34.3%	6.9	83.3%	B
U. OF VIRGINIA	VA	92.6%	93.8%	86.3%	7.5	92.0%	A
U. OF VERMONT	VT	65.1%	64.9%	63.3%	1.6	97.5%	A
U. OF WASHINGTON	WA	74.3%	74.7%	63.7%	11	85.3%	B
U. OF WISCONSIN-MADISON	WI	76.7%	78.6%	57.0%	21.6	72.5%	C
WEST VIRGINIA U.	WV	54.2%	55.7%	37.8%	18.1	67.8%	D
U. OF WYOMING	WY	57.6%	59.2%	50.9%	8.3	86.0%	B

Note: URM = underrepresented minority and comprises African-American, Latino and Native-American. Column 4 (URM - White Gap) = Column 2 - Column 3. Column 5 (URM - White Grad Rate Equity Score) = Column 3 / Column 2.

		Grade 6: Change in Access and Success							
		1	2	3	4	5	6	7	8
Institution Name	State	State's '01 HS grads URM %	Grads of flagship '05, URM %	Ratio '01 - '05	State's '86 HS grads, URM %	Grads of flagship '90, URM %	Ratio '86-'90	Ratio % change	Progress in Access and Success
U. OF ALASKA FAIRBANKS	AK	25.0%	14.7%	0.59	26.6%	11.9%	0.45	31.6%	↑
U. OF ALABAMA	AL	34.3%	15.7%	0.46	31.4%	8.4%	0.27	71.2%	↑
U. OF ARKANSAS AT FAYETTEVILLE	AR	23.4%	8.6%	0.37	21.3%	4.2%	0.20	86.1%	↑
U. OF ARIZONA	AZ	35.3%	17.8%	0.50	25.2%	8.5%	0.34	49.6%	↑
U. OF CALIFORNIA-BERKELEY	CA	40.9%	14.9%	0.36	27.8%	13.8%	0.50	-28.7%	↓
U. OF COLORADO AT BOULDER	CO	18.6%	7.5%	0.40	14.5%	4.3%	0.30	35.4%	↑
U. OF CONNECTICUT	CT	19.8%	10.1%	0.51	13.6%	3.7%	0.27	87.3%	↑
U. OF DELAWARE	DE	29.2%	6.8%	0.23	24.2%	3.5%	0.14	61.2%	↑
U. OF FLORIDA	FL	37.0%	19.6%	0.53	26.9%	9.9%	0.37	44.3%	↑
U. OF GEORGIA	GA	34.9%	6.4%	0.18	35.0%	4.6%	0.13	39.7%	↑
U. OF HAWAII AT MANOA	HI	6.4%	3.1%	0.48	2.7%	1.4%	0.51	-5.8%	↓
U. OF IOWA	IA	4.4%	4.7%	1.08	2.9%	3.2%	1.11	-2.7%	↓
U. OF IDAHO	ID	7.4%	4.9%	0.66	4.5%	3.2%	0.72	-7.4%	↓
U. OF ILLINOIS AT URBANA-CHAMPAIGN	IL	24.0%	11.6%	0.48	20.1%	6.5%	0.27	76.5%	↑
INDIANA U.-BLOOMINGTON	IN	9.8%	5.1%	0.52	9.5%	3.6%	0.38	37.6%	↑
U. OF KANSAS	KS	11.7%	6.5%	0.56	9.4%	4.7%	0.50	11.2%	↑
U. OF KENTUCKY	KY	9.0%	5.8%	0.65	8.5%	3.2%	0.38	71.8%	↑
LOUISIANA STATE U.	LA	41.2%	11.0%	0.27	39.4%	6.2%	0.16	69.5%	↑
UMASS AMHERST	MA	16.0%	7.6%	0.51	8.2%	4.9%	0.60	-15.2%	↓
U. OF MARYLAND COLLEGE PARK	MD	36.7%	16.9%	0.46	29.2%	9.0%	0.31	49.7%	↑
U. OF MAINE	ME	1.9%	3.7%	1.96	0.9%	1.0%	1.13	48.2%	↑
U. OF MICHIGAN-ANN ARBOR	MI	15.6%	12.1%	0.78	14.0%	5.6%	0.40	93.5%	↑
U. OF MINNESOTA TWIN CITIES	MN	8.0%	4.8%	0.60	2.7%	2.3%	0.85	-5.5%	↓
U. OF MISSOURI-COLUMBIA	MO	14.2%	6.5%	0.46	12.2%	3.2%	0.26	74.4%	↑
U. OF MISSISSIPPI	MS	47.4%	11.0%	0.23	48.4%	5.9%	0.12	90.3%	↑
U. OF MONTANA	MT	8.4%	4.5%	0.54	4.1%	3.7%	0.91	-41.0%	↓
UNC-CHAPEL HILL	NC	29.9%	13.4%	0.45	29.6%	7.2%	0.24	84.2%	↑
U. OF NORTH DAKOTA	ND	5.8%	3.2%	0.55	5.8%	3.3%	0.57	-3.3%	↓
U. OF NEBRASKA AT LINCOLN	NE	8.4%	3.7%	0.44	5.4%	2.0%	0.37	19.9%	↑
U. OF NEW HAMPSHIRE	NH	2.5%	2.3%	0.91	0.8%	0.8%	0.99	-7.5%	↓
RUTGERS U.-NEW BRUNSWICK	NJ	27.7%	16.1%	0.58	20.2%	11.2%	0.55	4.7%	↑
U. OF NEW MEXICO	NM	57.0%	43.4%	0.76	50.4%	26.6%	0.53	44.7%	↑
U. OF NEVADA-RENO	NV	23.5%	9.6%	0.41	14.7%	5.6%	0.38	7.2%	↑
SUNY AT BUFFALO	NY	26.4%	10.7%	0.41	20.5%	5.7%	0.28	46.0%	↑
OHIO STATE U.	OH	11.6%	9.5%	0.82	12.0%	3.8%	0.32	160.1%	↑
U. OF OKLAHOMA NORMAN CAMPUS	OK	28.4%	16.1%	0.57	19.8%	6.4%	0.32	75.3%	↑
U. OF OREGON	OR	9.1%	6.0%	0.66	5.3%	2.6%	0.49	34.9%	↑
PENN STATE U.	PA	13.1%	7.3%	0.56	10.2%	4.7%	0.46	21.6%	↑
U. OF RHODE ISLAND	RI	15.7%	7.4%	0.47	5.3%	2.2%	0.42	13.1%	↑
U. OF SOUTH CAROLINA AT COLUMBIA	SC	39.3%	18.4%	0.47	40.1%	12.9%	0.32	45.5%	↑
U. OF SOUTH DAKOTA	SD	5.0%	2.7%	0.54	4.4%	1.3%	0.29	88.4%	↑
U. OF TENNESSEE-KNOXVILLE	TN	18.7%	7.1%	0.38	19.5%	4.1%	0.21	80.2%	↑
U. OF TEXAS AT AUSTIN	TX	45.7%	17.0%	0.37	37.3%	12.2%	0.33	13.6%	↑
U. OF UTAH	UT	6.7%	4.1%	0.61	4.6%	3.3%	0.72	-15.4%	↓
U. OF VIRGINIA	VA	26.3%	11.6%	0.44	22.2%	7.5%	0.34	23.5%	↑
U. OF VERMONT	VT	0.8%	2.9%	3.51	0.6%	1.1%	1.77	98.7%	↑
U. OF WASHINGTON	WA	12.0%	7.7%	0.64	7.5%	4.9%	0.66	-2.5%	↓
U. OF WISCONSIN-MADISON	WI	8.3%	4.0%	0.48	5.6%	2.5%	0.45	7.2%	↑
WEST VIRGINIA U.	WV	4.0%	5.6%	1.40	3.7%	2.7%	0.74	90.4%	↑
U. OF WYOMING	WY	7.1%	4.6%	0.65	6.9%	4.0%	0.58	12.0%	↑

Note: URM = underrepresented minority and comprises African-American, Latino, and Native-American. Column 3 (Ratio '01 -'05) = Column 2 / Column 1. Column 6 (Ratio '86 -'90) = Column 5 / Column 4. Column 7 (Ratio % Change) = ((Column 3 - Column 6)/Column 6). The numbers that appear in columns 1-7 are rounded, but the numbers used to generate columns 3, 6 and 7 are not, so calculating the values for columns 3, 6, and 7 using the numbers in the chart may yield results slightly different from the numbers that appear in columns 3, 6, and 7.

Why Are Low-income and Minority Students so Underrepresented at Flagship Universities?

When asked why their campuses enroll and graduate so few low-income students and students of color, presidents of flagship universities often point to quality problems in the nation's high schools, especially those that serve significant concentrations of low-income and minority students. Like many presidents in other colleges, they would like Americans to believe that we have a high school problem, not a college problem.

Obviously, they're not all wrong. We do have important problems in our high schools. Most of them seriously shortchange poor and minority students and result in devastating outcomes for these groups.

Setting aside for the moment the question of whether higher education has any culpability for that sorry state of affairs, it is important to ask the bottom line question: Are the colleges right to think that it's *not* really about them? In other words, do achievement patterns in our high schools entirely explain access and success patterns in our flagship institutions, or could these institutions be doing more to serve the full range of students in their states?

When examined directly, the answer is clear. There is no way that achievement patterns in our high schools over the past two decades—which show vastly higher college prep course completion rates, stronger achievement in mathematics, and higher SAT and ACT scores for low-income and minority students—could possibly fully explain the poor and mostly worsening performance of our flagship universities.

Indeed, virtually every available source of data suggests that there are more students—especially low-income students—who could successfully do the work in these institutions if we only tried a little harder to get them in and through.

Let's take a look at what the data tell us.

A Quick Look at the Data on High-achieving Low-income Students

The best data sources for understanding the post-secondary experiences of America's high school students is the National Education Longitudinal Study (NELS). In general, analyses of these databases show large differences in the college-entry rates of high-achieving students from various economic backgrounds.

One such analysis, summarized in Table 1 below, found college-going rates among high-achieving, low-income high school graduates to be about the same as those among the lowest achieving students from high-income families. Indeed, almost one-quarter of the highest achieving students from low-income families had not entered any college at all within two years of graduating from high school.[19]

Table 1. College-Going Rates by Income and Achievement Levels

Achievement Level	*Low-Income*	*High-Income*
First (Low)	36%	77%
Second	50%	85%
Third	63%	90%
Fourth (High)	78%	97%

A second, more nuanced analysis of the NELS database found a similar pattern, with significant numbers of high achieving low-income students not in college a full two years after graduating from high school. But these analysts also found something equally important: that the high-achieving, low-income students who did enter college were considerably more likely than other high achievers to begin in two-year colleges,[19] a path far less likely to result in a baccalaureate degree.[20]

It turns out, though, that this stratification process—whereby high-achieving, low-income students enter less selective colleges than their high income counterparts—involves more than them just resigning themselves to attending two-year colleges.

A special analysis of the NELS database for the Education Trust shows that even the low-income students in the highest "academic resource quintile" (high achievement plus completion of intense college prep curriculum and AP courses) who entered four-year colleges enrolled in institutions with less status and fewer resources.[21]

By virtually any standard, these students' academic credentials would warrant admission to most of the top universities in the country. Yet nearly three-quarters of our country's best and brightest high school graduates from low-income families—those

who fell in the top quintile of a rigorous academic index attended colleges to which they could have gained admission had they simply achieved at a mediocre level.[22]

Certainly, as is clear in Table 2 below, there is some settling for less of high-achieving students at all income levels. But high-achieving, high-income students are nearly four times more likely to attend a highly selective college and nearly twice as likely to attend a selective college than are similarly accomplished students from the bottom three income quartiles.[23] Indeed, the differences between those at the highest and bottom three income levels represent both a stunning loss of talent and a devastating message back to the communities from which those lower-income, high achievers came about the disappointing opportunities available, despite hard work and early success.

Table 2. College Selectivity Level of Best Prepared High School Students by Income

	Selectivity	
Income Level	*Highly Selective / Selective*	*Non-Selective / Open-Door*
Highest quintile	56.2	42.9
2nd highest quintile	33.6	66.4
3rd highest quintile	23.9	74.9
4th highest quintile	22.2	77.2
Lowest quintile	26.8	73.2

How Many More High-achieving, Low-income Students Might Be Out There?

Together, these various analyses of the federal longitudinal databases provide an unequivocal answer to our core question. Yes, there are more high-achieving low-income students out there who could enroll in a flagship university but don't. Some of them are in other, less prestigious institutions. Some of them aren't in college at all.

But in part because the longitudinal data are old (most recent covers high school class of 1992), and in part because they are a sample, they don't easily lend themselves to answering the question, "How many?"

Fortunately, a recent analysis of a different database—students who took the SAT or ACT college admissions tests in 2003—provides some good clues. Though this analysis sought to provide estimates of how many low-income students might be sufficiently well prepared to enter highly selective, private colleges and universities. The data are also analyzed in ways that give us information about how many students at different income points perform at a level that should be sufficient for enrollment at a flagship.[24]

Because each flagship has slightly different admissions criteria, we identified the SAT/ACT score at the 25th and 50th percentiles for each institution and averaged them across all the flagships. We then took those score levels—which happen to be 1042 (ACT approximately 22) and 1146 (ACT approximately 25)—and asked the question: how many students who score within that range come from families in the bottom two income quintiles?

Based on this more recent analysis, nearly 110,000 students in the bottom two income quintiles scored at least an 1110 on the SAT (ACT approximately 24), which is right in the middle of the 25th and 50th percentiles for the flagships. If, according to our calculations, approximately 42,000 freshmen who attended flagships in the fall of 2004 were low-income students (as indicated by their status as Pell recipients), that would have left more than 60,000 other low-income, high SAT/ACT scorers who were likely candidates for admission to the flagships. This however, is a conservative estimate because another 238,000 students who scored at least an 1110 on these assessment tests did not report their income.[25] Given that students from low-income families are more likely than others not to report their income, we can conclude that there were actually many more low-income students whom the flagships could have recruited for admission to their institutions.[26]

Certainly some of these students attended other prestigious universities. But we know, based upon information from the longitudinal databases that many, in fact, went on to non-selective colleges, and others didn't go on to college at all.

How Flagships and Other Highly Selective Research Universities Use Their Own Resources

These numbers raise the question: Why aren't flagships doing more to attract such students? Are these universities, for example, deploying their own financial aid dollars in ways that ensure that the financial needs of students from low-income families are adequately met?

Unfortunately, although their wealth and prestige might have led us to hope otherwise, the nation's flagship universities used their own resources over the past decade in much the same way as have other colleges. Available data suggests that they spend, less and less on the truly needy and more and more to attract higher-income students who will make them look ever better in college guides.

Certainly, inadequate financial aid isn't the only cause of lower access and success rates for low-income students and students of color at the flagships. However, in this time of rapid escalation in college costs, it's hard not to see a connection between how and on whom institutions spend their available aid dollars and who actually enrolls.

Though the nation's flagship universities are public institutions and receive considerable support from the government, detailed information on how each of them deploys their own financial resources is not publicly available. However, as part of its periodic National Postsecondary Student Aid Survey (NPSAS), the Department of Education does collect data on student aid expenditures in various categories of institutions. "Research Extensive Universities" is one such category, and it includes 46 of the 50 flagships in our analyses, along with 56 other public research universities that are quite similar, along a number of different dimensions, to the flagships.[27]

We looked closely at the NPSAS data and were stunned by what we discovered.[28]

First, like many other universities, the flagships substantially increased the number of their own dollars devoted to grant aid over the past nine years. As Table 3 illustrates, between 1995 and 2003, Research Extensive Universities (REU) doubled the amount of institutional aid they awarded—from $616 per full-time student to $1,205 per student—an increase of 95 percent. These institutions now pick up a larger share of grant aid costs for their students—40 percent—than any other sector, dwarfing the federal share (20 percent), the state share (25 percent) and the private share (15 percent).

Second, as is clear from Table 4, some of that increase went to students from the poorest families. For example, the average award for students from families making less than $20,000 per year grew by $383. But both the dollar and percentage increases over the eight-year time frame were larger for students from the richest families, those earning more than $100,000 per year. To woo high-income students from other institutions they were considering attending, REUs increased the non-need based aid disbursed to this group by an average of $535 per student.

In other words, at the same time that they increased grant aid to the lowest income students by 29 percent, public research extensive universities increased grant aid to their wealthiest students by 186 percent.

Table 3. Change in Grant Aid Per Student at REUs, By Source of Aid, 1995–2003

Aid Source	*1995*	*2003*	*% Change 95 to 03*	*Amt. Change 95 to 03*
Institutional	$616	$1,205	96%	$589
State Grants	$334	$744	122%	$410
Federal Grants	$339	$577	70%	$238
Private Grants	$259	$452	75%	$193
Total Grants	$1,548	$2,978	92%	$1,430

Table 4. Change in Institutional Grant Aid Per Student at REUs, by Family Income, 1995–2003

Family Income	*1995*	*2003*	*% Change 95 to 03*	*Amt. Change 95 to 03*
<$20K	$1,311	$1,694	29%	$383
$20 - $39,999	$899	$1,716	91%	$817
$40 - $59,999	$529	$1,295	145%	$766
$60 - $79,999	$423	$1,254	196%	$831
$80 - $99,999	$210	$938	347%	$728
$100,000 +	$287	$822	186%	$535

It is important to note that the grant amounts in Table 4 are averaged across all students in that income category, regardless of whether or not they received aid. This is a good way to look at trends, but has the primary effect of masking just how large were the institutional grants to the high income students who actually received aid.

Table 5 provides award data for the students who actually received grant aid. The average award for students from families earning more than $100,000 per year was $3,800. At the same time, the average grant to students from the lowest income families actually declined, so that by 2003 these institutions were giving the affluent aid recipients more money than the students who need financial aid the most.

Table 5. Change in Institutional Aid to Grant Recipients at REUs, by Family Income, 1995–2003

Family Income	*1995*	*2003*	*% Change 95 to 03*	*Amt. Change 95 to 03*
< $20K	$3,756	$3,691	-2%	-$65
$20 - $39,999	$2,871	$3,479	14%	$392
$40 - $59,999	$2,554	$3,616	41%	$1,062
$60 - $79,999	$2,503	$3,676	47%	$1,173
$80 - $99,999	$1,998	$3,423	71%	$1,425
$100,000 +	$3,223	$3,823	19%	$600

Third, as is demonstrated in Table 6, even after deducting average grant aid received from all sources from the estimated total cost of attending these institutions, students at every income level were left with significant expenses that they had to meet through a combination of work, loans and family contributions.

We are by no means suggesting that students and their families, at all income levels shouldn't be responsible for some of the costs associated with attending college. To the contrary, it is perfectly acceptable for students to work a reasonable number of hours (preferably no more than 10) to earn money while attending college, or take out a manageable loan amount to help finance their college degrees. But it makes no sense at all that the neediest students are forced to work an excessive number of hours and to assume thousands of dollars in loans, just to ensure that they can stay enrolled from one semester to the next.

For students from the lowest income families, their remaining costs, after grant aid was considered, constitute approximately 80 percent of their families' annual incomes. Imagine needing three-quarters of your family's income every year for at least four years, to pay for your child to go to college! Now suppose that you had more than one college-aged child.

These scenarios make it easier to understand why some of the brightest high school students feel forced to attend less selective and less expensive, universities even when they are qualified to attend much more prestigious institutions.

Fourth, a natural outgrowth of the shifts we've just described is a dramatic change in the composition of the student bodies at these universities in just eight years time. In 1995 students from families earning less than $20,000 per year represented 14 percent of undergraduates at these institutions; today, they account for only nine percent. At the other end of the income spectrum, there were substantial increases in the number of students from

Table 6. Change in Percentage of Income Needed for Remaining Costs at REUs after Grant Aid, by Family Income, 1995–2003

Family Income	*1995 Mean Income*	*2003 Mean Income*	*1995 % of Income*	*2003 % of Income*
< $20K	$11,500	$12,300	66.8%	79.5%
$20 - $39,999	$29,800	$30,300	31.2%	37.2%
$40 - $59,999	$50,700	$50,100	20.8%	27.5%
$60 - $79,999	$69,900	$69,600	16.1%	20.9%
$80 - $99,999	$89,000	$90,100	13.5%	16.4%
$100,000 +	$133,100	$136,700	9.2%	11.8%

families earning more than $100,000 per year at these schools—from 16 percent of undergraduates in 1995 to 28 percent just eight years later.

Finally, the sheer number of institutional dollars spent on financial aid for students who don't need it is amazing. Table 8 contains information on total institutional aid expenditures for students from families at each income level. Collectively, in 2003 these public universities committed $171 million to

Table 7. Change in Percentage of Students at REUs by Family Income, 1995–2003

Family Income	*1995*	*2003*	*Percentage Pt. Chg 1995 to 2003*
< $20K	14%	9%	-5
$20 - $39,999	19%	15%	-4
$40 - $59,999	21%	16%	-5
$60 - $79,999	18%	18%	--
$80 - $99,999	11%	14%	+3
$100,000 +	16%	28%	+12

students from families earning less than $20,000 per year. This figure seems laudable, but only until it is compared with the astonishing $257 million these same institutions spent on students from families earning more than $100,000 per year.

Thus the institutions that arguably had the most to spend on student grants collectively gave $86 million more to their highest-income students than they did to their students with the greatest financial need.

Given the way that the REUs chose to allocate their financial aid dollars, it is not surprising that the number of students who received institutional grant aid and came from families earning more than $100,000 per year increased from 32,000 in 1995-96 to 119,000 in 2003-04. During the same time period, the number of institutional grant aid recipients from families earning less than $20,000 decreased from 118,000 to 89,000.

These dollar figures tell a disturbing story about the choices made by public research universities, including the flagship universities that are the subject of this paper. Though they are all public institutions that receive (albeit in some cases declining) public subsidies, their decisions about how to disburse their institutional grant aid have been much like those of private universities.

The saddest choice of all is this: these universities find it more important to use their own money to buy high-income students, who will almost inevitably attend an elite institution no matter what, than to expand the enrollment of—or lower the financial burden on—low-income students. These students depend on institutional aid to make their dreams of going to college a reality in ways that high-income students do not.

Of course, federal and state aid dollars (not to mention tax credits) are shifting toward upper income students, too. There's not much these institutions can do about that. But they could deploy their own resources differently to cushion or counteract changes in the way that federal and state aid are distributed.

Unfortunately, however, they choose not to. Indeed, as is clear from our analyses these universities are shifting resources to middle and upper class students far more aggressively than the state and federal politicians who presumably did so to win votes. And the leaders in these universities don't even have to stand for election.

Table 8. Change in Institutional Aggregate Grant Aid For REU Students by Family Income, 1995–2003 (Dollar amounts in millions)

Family Income	*1995*	*2003*	*Amt. Change*	*Pct. Change*
> $20K	$196.6	$171.0	$25.6	-13%
$20 - $39,999	$187.0	$288.3	$101.3	54%
$40 - $59,999	$122.2	$229.2	$107	87.6%
$60 - $79,999	$82.5	$259.6	$177.1	214.6%
$80 - $99,999	$25.2	$147.3	$122.1	484.5%
$100,000 +	$50.8	$257.3	$206.5	406%
Total	**$664.3**	**$1,353**	**$688.4**	**104%**

Renewing Our Commitment to Low-Income and Minority Students

The institutions that earned good marks on one or more of the measures on our report card give us hope that these negative patterns can be turned around. What some institutions have done, others can do too.

They also provide examples of the policies and practices that lead to greater success. If it's not just about the levels of preparation among the students these institutions serve—and it is clearly not—then what, exactly, are the high performers or big gainers doing that the rest of us could do too?

The Universities of Maryland, Minnesota, Virginia, and North Carolina have already developed efforts to help them better serve their states' underrepresented students. Ohio State University also offers an important example of what a flagship university can do when it sets out to widen access for low-income and minority students.

Ohio State University: Moving up in access and success

Ohio State University (OSU) used to be an open-enrollment institution, so when it raised its entrance requirements, there were fears that it would become more elite and less diverse. Because the university, as the economic and intellectual engine of Ohio, wants to stay true to its mission to educate a broad section of Ohio's citizens, it not only aggressively recruits low-income and minority students, but also has initiated a series of programs to retain them. Now 26 percent of the student body qualifies for Pell Grants and on Grade 6 of our scorecard, OSU has the highest trend grade for access and success for underrepresented minorities.

Tally Hart, OSU's long-time director of financial aid has been appointed Senior Advisor for Economic Access. She is working on ways to recruit students from families who are expected to make a family financial contribution of $1,500 or less per year, the most needy of OSU's students. In her research, Hart found that these families were reluctant to encourage their children to apply to OSU for fear that they were courting disappointment. The families and the communities surrounding them were unfamiliar with financial matters because in many cases their incomes were so low that they did not file income tax statements.

Hart is using the information she gleaned from those families to help demystify the application process for students who are similarly needy but do not apply. She has already begun working with chess clubs in many of the state's public schools and talking to them about applying to college. She is also planning on working with 4-H clubs to try to reach low-income rural students.

Once admitted to OSU, these students face severe financial pressures. Tally says, "To our real surprise, these neediest students were taking on a great deal of consumer debt--credit cards—which may have contributed to their leaving college." Their financial aid packages were significantly changed, in an attempt to meet more of their needs that were not met by Pell and other grants. The university also tries to steer them away from borrowing from unsubsidized loan programs and to keep their total loan packages low. But, Hart says, "even small loan amounts are problematic if you don't finish your education."

The OSU has undertaken a number of other initiatives aimed at connecting students more closely to the institution so that they do finish their education and are thus in a better position to repay any loans. Administrators make sure students with the greatest need hold work-study jobs on the campus, not only to help them financially but also to help them structure their time productively and to make sure that they have another adult in their lives who can keep an eye on their academic progress.

In addition, the OSU provides a freshman-year experience which includes seminars taught by faculty who are selected because of their success in teaching undergraduates, pre-academic year freshman programs for hundreds of students, thus providing a nucleus of students who know each other before the year begins, a two-day freshman orientation (up from the one-day orientation Ohio State used to offer), and small learning communities that offer students the opportunity to live in the same dorm as other students taking the same courses.

Hart cites research that shows that students who are successful tend to have at least one strong relationship with a faculty member. "We have a new office of undergraduate research directed by one of our highly prized faculty members," Hart says. A donor has provided money to help students with prizes and travel opportunities so that, for example, if a student's name is on a paper that is being presented at an academic conference, the student will be able to travel with the faculty member to present the paper. Several hundred scholarships are providing students with, for example, computer programs needed to undertake research or money to join an archaeological dig in Greece.

To make sure third- and fourth-year students are able to graduate, the university is streamlining registration procedures so courses that students need to fulfill their graduation requirements are offered in sufficient numbers. OSU's alumni have also been recruited to provide internships and co-op opportunities for current students.

Ohio State's progress can be tracked by looking at the four-year graduation rate numbers. In 2002 it was 25.3 percent and its six-year graduation rate was 58.8 percent. In 2004, the four-year rate was 30.7 percent while the six-year graduation rate was 62 percent.

Although this seems like slow progress, it represents a leap for some groups. African-American females, for example, improved their four-year graduation rate from 21.8 percent in 1999 to 30.6 percent in 2005. African-American males more than doubled the rate at which they graduated in four years during that time, from 7.3 to 16.4 percent.

This fall OSU announced a freshman-to-sophomore retention rate of 91.5 percent, which is considered high for a large state university and may be a harbinger of improved graduation rates in three years' time.

Moving Forward

As wealth in this country grows ever more concentrated and economic mobility declines to the lowest point in decades, leaders in the nation's flagship universities—including boards of trustees, presidents and faculty—face a critical choice. They can choose to ride the wave of prosperity among Americans at the top of the economic pyramid, and in the process enrich their institutional coffers. Or they can broaden opportunities for success among minority youngsters and those from low-income families and enrich the communities and states they were created to serve.

The data in this report make clear that, over the past decade, these institutions have turned away from their historic roles as engines of opportunity for talented young people of all races and economic backgrounds. Not, perhaps, deliberately. But they have turned away, nevertheless.

In some ways, this isn't surprising. After all, virtually all of the rewards in today's perverse college status systems go to institutions that select only the students easiest to educate. And cutbacks in state support for higher education have made leaders in public universities acutely sensitive to the need to find new strategies to raise support wherever they can. Indeed, such leaders would feel lacking in their duty to the long-term greatness of their institutions if they did otherwise.

But while perhaps not surprising, this turn away from their historic commitment is deeply troubling.

Some might argue that expanding college access and success for low-income and minority students is mostly a job for other institutions—especially "lesser" institutions. In their minds, the flagship universities are about excellence, not equity—as if the two were somehow incompatible.

We would argue just the opposite.

First, in the America we aspire to be, excellence and equity are not only *compatible*, they are *inextricable*. We need to find a way to realize that essential touchstone of our national identity.

Second, without the active leadership and participation of our flagship universities, it is hard to imagine *any* way to bring the "two Americas" closer together. Certainly, these institutions contribute directly to the creation of their states' leadership corps and they also exercise broad influence: where they go, others will follow. That's what being a flagship means.

So what might leaders in the flagship universities do to make sure they are developing the talents of all our students?

Many things need to change in order for higher education—including our premier public universities—to become the engine of opportunity that our country so desperately needs. There are also important roles for federal and state governments, for schools and for students themselves.

These roles are described in some detail in our August 2006 report, *Promise Abandoned*. That report called on key actors at every level—federal, state and institutional—to recommit to the ideals we hold dear as a country, and to put the needs of low-income students first. That doesn't mean that we can't help middle-income students, too.

But it does mean that, before we spend money on students who don't really need it to attend college, we must first honor our commitment to students from low-income families who cannot attend college without help. The message to them must be clear, unequivocal and sent early enough to make a difference: if you work hard in school, you won't have to worry about being able to afford a college education.

Promise Abandoned also made clear what many in higher education have now come to realize: we must begin to think very differently about what constitutes "quality" in higher education. Now, colleges get a lot of their status from things that have very little to do with the fundamental purposes of higher education—things like how many applicants they turn down for every one they accept, the average SAT or ACT of their freshmen, or the winning record of their football teams. If higher education is to do its fair share of the work in widening opportunity in this country, we need very different metrics for assessing quality—metrics that recognize institutions for who they serve and for what they do with the students they admit. Instead of bestowing status on colleges that admit only students who will succeed no matter what, we need to honor and support institutions that are helping students who face far more difficult challenges to earn the degrees they need to contribute to the well-being of their families and our nation.

Beyond these things, though, what might leaders in the flagship universities do to make sure they are developing the talents of more low-income students and students of color?

Recommendations

1. Start with the data.

Institutions first need to come to grips with their own data. Just as presidents and trustees can recite the average SAT or ACT scores of their most recent freshman cohort and the win/loss record of the football team, they should know their university's basic statistics regarding access and success. At the very least, every campus president, dean or department chair and trustee of a flagship campus should know:

(1) the extent to which their institution serves the full breadth of its state's residents;

(2) the overall graduation rate for entering freshmen;

(3) gaps in graduation rates between groups of students; and

(4) the proportion of institutional grant aid awarded to students from families in the bottom half of the family income distribution.

These data should guide how universities define and evaluate their success, and should also play a prominent role in public conversations about institutions goals and accomplishments.

2. Focus on increasing the success of students already admitted.

Most flagships have already admitted a certain albeit small number, of low-income and minority students. But without greater effort on the part of the institutions themselves, many of these students will never graduate. What could flagship universities do?

Though graduation rates for minority students who attend flagship universities are higher than the rates for such students in other universities, those rates are not as high as they should be. Many institutions don't even know the graduation rates for their low-income students.

No single strategy will solve the problem, and certainly more generous aid packages will help. But so, too, will stronger advising; deeper engagement with faculty and with the subjects they came to study; and better connections with campus life. Sometimes it's even as simple as eliminating the frustrations that come from not getting access to a required course by adding an additional section or two of that course. But mostly it's a question of taking more responsibility for student success and making sure that ethic permeates all units of the institution.

3. Aggressively recruit more talented low-income students and students of color

Every available source of data says the same thing: there are far more low-income students and students of color who meet the high standards of flagship universities than ever enroll there. They may not always show up in the usual places. Indeed, available research suggest that such students—and the high schools that they attend—receive far fewer mailing and visits from selective colleges than their more affluent peers.[29] But they are there nevertheless. Flagship leaders need to devote some of that creative energy that their institutions are noted for to devising ever better ways to reach and attract these students. Setting clear stretch goals would help. But reaching those goals will require real effort and real creativity.

4. Reallocate institutional aid dollars.

Remember, institutional aid dollars in Research Extensive Universities dwarf federal and state grant dollars. Over the past eight years, the amount spent on students from families above $100,000 per year increased from $51 million to $257 million, while the amount spent on students from families below $20,000 per year went down. By shifting a portion of that $207 million increase spent on children of the rich, these universities could shield their low-income students from most of the effects of high unmet need.

Yes, we understand that giving some grant aid to high-income students allows the flagships to enroll top-notch students who otherwise might choose to attend a different school. But, if just half of the funds currently distributed to high-income students were reallocated in the form of need-based aid to qualified students in the lowest income bracket, it would significantly reduce the financial burden on these students and their families and probably contribute to their ability to graduate in a timely manner. The University of Maryland has already done this with its Maryland Pathways program which increases the grant component, and eliminates the loan component of its neediest students' financial aid packages.[30]

The amounts spent on the rich should be capped. Flagship university leaders could also agree to disarm their efforts to compete with

one another and with other elite institutions, for high-achieving well-to-do students. There's nothing wrong with awards for exceptional artists or science contest winners. But public institutions should not regularly discount tuition for students from families over $100,000 per year. A disarmament pact would be great, but short of that, courageous leaders should step forward and disarm unilaterally.

5. **Reach out and reclaim students who left in good standing, but without a degree.**

Ten years ago, leaders at the University of New Mexico, the state's flagship university, realized that most of the students who dropped out actually left in good standing, many of them only a handful of units short of a degree. So they launched the Graduation Project, and hired a bill collector to track down students who left in good academic standing and needed 30 credits or less to meet the university's graduation requirements. The University invited them back, simplified the readmission process, and paid half of the tuition, up to $800, for returning students with a 2.5 cumulative GPA. Since its inception in 1996, more than 1,100 UNM students have earned their bachelor's degrees through this effort.[21] Other flagships should create their own versions of the same thing.

6. **Commit to preparing more high-quality teachers for high-poverty and high-minority schools.**

Research conducted around the country makes it very clear that the most important thing that higher education could do to improve achievement and college readiness among low-income and minority students is to prepare well qualified teachers to teach in those schools. And it matters, frankly, who produces those teachers. Almost by definition, flagship universities are more likely than other institutions to attract the kind of future teachers with the intellectual capacity to succeed in the enormously complex work of teaching even the poorest children to high standards. Certainly, flagships can't do it all. But far too many have taken their roles as the epicenter of research for their states to the extreme, and have left educating the teaching workforce to other colleges and universities.

That needs to change. Fortunately, in some flagship universities, it already is. The University of Texas-Austin, for example, has launched UTEACH which is aimed at increasing the number and diversity of science and math teachers. [22] Since the program's inception the University of Texas-Austin has doubled the number of Math and Science majors who go into teaching.

Of course, other things need to change to help make sure that America is developing all of her talent. There are important roles for the federal and state governments, for schools, and for students themselves. For a fuller set of recommendations see our fourth report in this series, *Promise Abandoned*.

But flagship universities don't have to wait on anyone else to act. They have sufficient wealth and prestige to risk a little of both for this purpose. Virtually all of them occupy an almost mythic place in the psyche of their states: they decide who has the inside track to the upper echelons of public office and private enterprise.

With that special status comes special responsibility. To create the next generation of leaders for our country, we need the current generation of leaders in these institutions to reaffirm their historic commitment to opportunity and set a new course.

Endnotes

[1] The College Board (2005). *Advanced Placement Report to the Nation, 2005*. New York, NY: The College Board.

[2] Margaret Cahalan, Steven Ingels, Laura Burns, Michael Planty, Bruce Daniel, Jeffrey Owings. (2006). *United States High School Sophomores: A Twenty-two Year Comparison, 1980-2002*. NCES. Washington, DC: U.S. Department of Education.

[3] We have identified 50 flagships, one for each state. We acknowledge that not every state designates one of its public universities as its flagship institution, and that some states might recognize, at least informally, more than one flagship institution. Following are a few examples of other research reports of flagship universities that only include 50 institutions: 1) Tom Mortenson (August 2004). Underrepresented Minorities Share of Undergraduate Enrollments at State Flagship Universities 1992 and 2002. *Postsecondary Opportunity Number 14*; 2) *2005-06 Tuition and Fee Rates: A National Comparison*. The Washington Higher Education Coordinating Board (January, 2006); 3) JBHE Completes It Count of Black Students and Faculty at the Nation's 50 Flagship State Universities. *Journal of Blacks in Higher Education*, Spring 2006. With few exceptions, the flagships included in our analyses are the same as those in the previously mentioned reports.

[4] All income and grant figures come from a special analysis of the *National Postsecondary Student Aid Study* (2003-2004), conducted by Jerry Davis for the Education Trust.

[5] Ibid.

[6] Ibid.

[7] Education Trust analysis of Integrated Postsecondary Education Data System (IPEDS) data.

[8] National Educational Longitudinal Study. Data analysis conducted by Clifford Adelman for the Education Trust.

[9] Current Population Survey. Total Money Income in 2005 by Race and Type of Family Work Experience. Retrieved October 27, 2006 from http://pubdb3.census.gov/macro/032006/faminc/new03_001.htm

[10] Education Trust analysis of Pell data from Tom Mortenson Retrived October 30, 2006 from www.postsecondary.org/spreadsheetsPW/pellmasterdocument.xls.

[11] Education Trust analysis of Common Core of Data (CCD). NCES.

[12] Education Trust analysis of Integrated Postsecondary Education Data System (IPEDS).

[13] Education Trust analysis of Pell data from Tom Mortenson.

[14] Education Trust Analysis of IPEDS data.

[15] Term used by Tom Mortenson in a recent report, The Gated Communities of Higher Education: 50 Most Exclusive Public and Private 4-Year Institutions, 2003-2004. *Postsecondary Opportunity*, 162, December 2005.

[16] Although we typically use a six-year graduation rate, most entering freshmen who graduate from college do so four years after entering. Therefore, instead of comparing flagship graduates to high school graduates six years prior, we have chosen to compare the flagships' 2005 graduates to high school graduates from 2001. Education Trust analysis of data from the CCD and IPEDS.

[17] For Grade 1 we follow the example of Estela Bensimon et al. (2006), Measuring the State of Equity in Public Higher Education, in *Leveraging Promise*, SUNY Press. Laura Perna and colleagues (2006) also use this ration in The Status of Equity for Black Undergraduates in Public Higher Education in the South: Still Separate and Unequal in *Research in Higher Education 47*, (2).

For Grade 2 we follow the example of Mortenson in *Pell Grant Shares of Undergraduate Enrollments in Postsecondary Institutions*, October 2005.

[18] NELS:88, Second (1992) and Third follow-ups (1994), in *The Condition of Education 1997*, p. 64.

[19] Anthony Carnavale and Stephen Rose. (2003). Socioeconomic Status, Race/Ethnicity, and Selective College Admissions.. New York, NY: The Century Foundation.

[20] Lutz Berkner, Shirley He, Emily Forrest Cataldi (2002). *Descriptive Summary of 1995-1996 Beginning Postsecondary Students: Six Years Later*. NCES Statistics. Washington, D.C: U.S. Department of Education.

[21] Data analysis of NELS conducted by Clifford Adelman for the Education Trust.

[22] Students in the top quintile of the academic curriculum intensity variable accumulated at least 3.75 units of English, 2.75 units of mathematics with the highest course being calculus, precalculus or trigonometry; 2.5 units of science; 2 units of foreign languages; 2 units of social studies and more than one AP course. In Clifford Adelman's (2006), *The Toolbox Revisited: Paths to Degree Completion from High School through College*. Washington, DC: U.S. Department of Education.

[23] Data analysis of NELS conducted by Clifford Adelman for the Education Trust, which showed that while 16.5 percent of students from the highest academic resources and highest SES quintile went on to highly selective colleges, only 2.4 percent, 4.7 percent, and 4.5 percent of students from the same academic resources quintile, but the middle, second lowest, and lowest SES quintiles, respectively, went on to highly selective colleges.

[24] Hill, C.B., & and Winston, G.C. (2006). How Scarce are High-Ability, Low-Income Students? In McPherson, M.S. & Schapiro, M.O., (Eds.), *College Access: Opportunity or Privilege?* New York NY: The College Board. For the complete table of SAT/ACT estimates see p.79.

[25] A full explanation of how we calculated these figures can be found in the Technical Appendix.

[26] Hill & Winston p.99.

[27] Until very recently, the Carnegie Foundation classified postsecondary institutions according to the level and number of degrees they awarded. The highest definition was doctoral research extensive. This is the group that we include in our analyses.

[28] All of the data included in this section of the report were derived from the NPSAS (2003-2004). Data analysis conducted by Jerry Davis.

[29] Don Munce. (2005). Achieving Diversity on Campus: A Better Approach. *Diverse Issues in Higher Education*, 22 (23) p.43.

[30] For more information on the Maryland Pathways program visit http://www.financialaid.umd.edu/MarylandPathways.html

[31] For a detailed description of the University of New Mexico's Graduation Project, see *Choosing to Improve: Voices from Colleges and Universities with Better Graduation Rates*. Washington, DC: The Education Trust (2005).

[32] For an explanation of the UTEACH initiative, see The National Association of System Heads (NASH). *Turning the Tide: Strategies for Producing the Mathematics and Science Teachers Our Schools Need*. Washington, DC: NASH (2006).

The technical appendix for this report is available at www.edtrust.org.

College Results Online

In 2005, the Education Trust created a new, interactive, web-based data tool called College Results Online (www.CollegeResults.org). It allows users to select any four-year public or private non-profit college or university in the country and see how its graduation rates compare with those of other institutions that are most similar, based on 11 factors that are statistically related to graduation rates, ranging from median scores on college admissions exams to the percentage of students receiving federal Pell Grants.

College Results Online shows that very similar institutions often have very different graduation rates. These differences are not trivial. A typical analysis comparing one university to the 25 most similar institutions produces a range between the highest and lowest graduation rates of 30 percentage points or more. The highest-performing school can have a graduation rate *double* that of the lowest. For students, the impact of these differences between institutions that otherwise look the same is huge.

College Results Online also allows users to study graduation rates broken down by students' race, ethnicity, and gender within a single institution. That information – which has only recently become publicly available for all four-year colleges and universities – also reveals significant graduation-rate gaps between White students and students of color. Users can sort schools according to the size of their graduation-rate gap, as well as examine how overall graduation rates at individual colleges and universities increased or decreased over time.

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College Tuition Pricing and Federal Financial Aid: Is there a Connection?

Testimony before the U.S. Senate Committee on Finance

Dr. Bridget Terry Long
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Harvard Graduate School of Education

Hearing: "Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail, or Need Improvement?"

December 5, 2006

Mr. Chairman and members of the committee, thank you for the opportunity to appear before you today. As we consider the tax exemptions of colleges and universities and the financial aid benefits afforded to students and their families, it is useful to take a moment to closely examine how tuition prices are determined. One key question is whether colleges and universities react to increases in federal financial aid and tax benefits by raising their tuition prices. If so, efforts to improve student access and affordability by increasing federal student aid would be ineffective as students would realize little benefit. And so today I consider the degree to which federal financial aid is bid away by the actions of colleges and universities.

As my testimony will illustrate:

- **Concerns about colleges raising tuition prices in response to federal aid appear to be largely unwarranted.** Most studies conclude that colleges are *not* responding to federal aid, and studies that do provide limited support for the notion are plagued by mixed and sometimes contradictory results.
- Evidence suggests growth in tuition prices is instead related to a myriad of other internal and external factors.
- However, when considering questions of college affordability, **attention should instead be focused on the *Net Tuition Prices* students actually pay** rather than the tuition amounts listed in college catalogues as students receive significant amounts of aid from colleges and universities in addition to government sources.
- While monitoring the behavior of colleges is important, policymakers should instead focus on addressing the well-documented need for additional financial aid resources.

BACKGROUND: DO INCREASES IN FEDERAL STUDENT AID CAUSE COLLEGES TO RAISE THEIR TUITION PRICES?

There is no doubt tuition prices have grown substantially in recent decades. Understanding why college prices have outpaced inflation is critical as families increasingly struggle to meet the costs of higher education. One concern is that policies aimed at improving college access and affordability may actually contribute to the problem of rising tuition levels. William Bennett, former Secretary of Education, summarized the concern in a 1987 *New York Times* Op Ed. He notes that because government aid enables students to pay more, it could also induce colleges to raise their tuition prices. *If true, this type of institutional response could diminish the overall impact of an aid policy by reducing the net discount a student receives.* Therefore, such concerns deserve careful examination as the implications for student affordability and the effective use of tax dollars are significant. Moreover, the behaviors of colleges are important to consider when devising student aid policy and higher education tax benefits.

The fact that Financial Aid has increased at the same time as Tuition Prices does not prove that Colleges have responded to Federal Aid Policy

In discussions of whether increases in government aid have spurred similar increases in tuition prices, some juxtapose rising college prices with increasing government expenditures on financial aid. However, the fact that these two trends move in similar directions does not mean that one has *caused* the other. In fact, in the absence of financial aid, one would still expect tuition prices to increase substantially during the last several decades for a number of reasons. While I will detail the major internal and external pressures that have impacted tuition levels in recent years, explanations include reductions in state appropriations to public colleges and universities, increasing amounts of institutional financial aid, and growing expenditures on student academic supports. Given the myriad of these *other factors* that directly contribute to rising college costs, it is difficult to determine to what degree, if at all, increases in tuition prices are related to changes in government student aid policy. To correctly answer the question of whether financial aid policy has an effect on college tuition pricing, much more in depth analysis is required than simple comparisons of price and financial aid expenditure trends.

Isolating the Effect of Federal Aid on Tuition Levels is Difficult

The potential implications for college affordability raised by this issue have led numerous researchers to try to identify whether postsecondary institutions respond to government financial aid policies in their pricing. My testimony will draw upon their many conclusions. Unfortunately, isolating the effect of government aid from all the other factors influencing college pricing is difficult. To deal with this concern, researchers have tried to identify groups of colleges that are *not* affected by the particular aid policy so they can get a sense of tuition trends due to all *other* factors that impact college price. The difference in price trends between the group affected by the aid policy and the group that was not affected could reflect the proportion of tuition influenced by the financial aid policy alone.

Unfortunately, in the case of federal aid, it is extremely difficult to determine a relevant comparison group. Institutions in other countries face vastly different markets and

trends, and therefore, do not serve as a good comparison group for American colleges and universities. Meanwhile, all institutions in the United States are affected by changes in federal aid policy to some degree, and institutions that are impacted differently by changes in federal aid programs often differ significantly in other ways that make them bad groups for comparison. For example, colleges that are especially affected by changes in the Pell Grant (e.g. community colleges) are very different than colleges that would not be affected much (e.g. highly-selective, private institutions). Price trends between these two groups differ in ways that have nothing to do with aid policy, making them poor comparisons for each other. These issues of research design must be taken into account when interpreting the results of any study. Some studies have been able to isolate the impact of financial aid on tuition pricing better than others, and my conclusions take this into account when interpreting the evidence.[1]

WHAT DO WE KNOW FROM THE EVIDENCE?

Of the many studies that have tried to identify whether colleges react to federal financial aid, most find little to no response. While several studies do find a college price response, their overall results are mixed and often contradictory. In summary, none of the numerous studies on the subject have found a "Smoking Gun" in terms of college pricing behavior.

In a 2004 study, I examined the response of colleges to the introduction of two federal higher education tax benefits, the Hope and Lifetime Learning Tax Credits.[2] The results suggest that four-year colleges did not raise tuition prices in response to the aid. While some estimates in this study suggest that public two-year colleges may have reacted by raising their prices, other results do *not* support this notion. In fact, some estimates suggest colleges *reduced* their prices in response to the tax credits, the opposite of what theory would predict.

In another study, Rizzo and Ehrenberg (2003) examine how tuition prices are set by public universities and find no evidence that the schools increase their tuition levels in response to increased federal or state financial aid for students. Likewise, in forthcoming work, Singell and Stone find no evidence that in-state tuition levels at public universities responded to changes in the Pell Grant from 1989 to 1996. This study did find some support for the notion that private colleges and universities raise tuition prices in response to aid. However, because these institutions have few Pell recipients (i.e. they have few students impacted by the change in aid policy), the results seem attributable to factors other than government aid policy. Limitations with the data prevent more conclusive analysis.

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[1] I have also chosen to focus on papers that have undergone some form of peer review (though not necessarily publication) to ensure the quality of the research.

[2] See Long (2004a). "The Impact of Federal Tax Credits for Higher Education Expenses." In Caroline M. Hoxby, Ed. *College Choices: The Economics of Which College, When College, and How to Pay For It.* Chicago: University of Chicago Press and the National Bureau of Economic Research.

There is some evidence of colleges responding to aid at the state level, but this does not apply to the federal student aid context.

I have also examined the responses of colleges to the Georgia HOPE Scholarship, a state financial aid policy.[3] Unlike research on federal aid programs, this study has a clear comparison group of colleges facing similar trends: institutions in other states. When introduced in 1993, the Georgia HOPE Scholarship marked the creation of a very large aid source for students ($3,000) in which the recipients were easily discernable by colleges and universities. My examination of college behavior suggests a limited response among four-year colleges to the scholarship, with public four-year colleges experiencing increases in room and board but not tuition prices. While some may be tempted to extrapolate from this evidence to the federal context, the estimates from this paper *do not apply*. Federal aid programs are much more complicated and less transparent and so it is less clear how institutions might take advantage. Moreover, changes in federal aid are far less generous (i.e. only several hundred dollars) and so colleges have much less incentive to respond. It is also important to note that even in the extreme case of the Georgia HOPE Scholarship, public two-year colleges did *not* increase tuition prices.

The key outcome of interest should be Net Tuition Price, the costs students face after government and institutional financial aid. More information is needed on how institutional financial aid is spent.

While most of the attention on this question has focused on the effects of government aid on the List Tuition Prices of colleges (the price listed in college catalogues), the real variable of interest should be the price *actually paid* by students once accounting for multiple types of financial aid. According to federal data, in 2003-04, 28 percent of students received grant aid from the federal government, and 15 percent received state grants. In addition, students increasingly receive grants from their colleges or universities with 18 percent receiving an average grant of $4,200 in 2003-04 (NCES, 2005).[4] The proportion receiving grant aid is even higher among full-time students. Once taking into account these multiple sources of assistance, the cost of college for the average student does not appear to have grown as fast as List Price trends suggest. According to figures by the College Board for private, four-year colleges, from 1996-97 to 2006-07, the average List Price grew 32 percent to $22,200, but Net Price increased by only 26 percent during the same time period to $13,200. At public, four-year colleges, List Prices increased 49 percent to $5,800 from 1996-97 to 2006-07 while Net Prices grew 29 percent to $2,700 (College Board, 2006). It is important to keep in mind that these are averages, and that Net Prices vary significantly among students.

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[3] See Long (2004). "How do Financial Aid Policies affect Colleges? The Institutional Impact of the Georgia HOPE Scholarship." *Journal of Human Resources*, vol. 39, no. 3.

[4] This marks significant growth in the use of institutional aid. According to Horn and Peter (2003), the percentage of undergraduates in public colleges who received institutional aid grew from 17 percent in 1992-93 to 23 percent in 1999-2000, from an average award of $2,200 to $2,700. At private colleges and universities, 47 percent of students received institutional aid in 1992-93, and this increased to 58 percent in 1999-2000, with the average award rising from $5,900 to $7,000.

While Net Price gives a better sense of the costs students actually face, it is also a better indicator of the reactions of colleges to government aid policy. Changes in Net Price would reflect whether colleges respond by not only altering their List Tuition Prices but also possibly their institutional aid policies. One study with administrative data on net price found that increases in government aid were coupled with *increases* in institutional scholarships at private colleges, (McPherson and Schapiro, 1991). Therefore, contrary to the concern about colleges taking advantage of government financial aid, the researchers found colleges further supplemented the support students received. While major conclusions should not be made based on one study, the findings highlight the importance of gathering more information, especially concerning net prices, to fully understand possible reactions of colleges in terms of their institutional aid awards to students.

More information about institutional financial aid is also needed to understand trends in college affordability for different types of students. The increasing use of institution financial aid has made college prices much more individualized and complicated, as students at the same school may be charged vastly different prices. In fact, the growing use of institutional aid partly explains why List Tuition Prices have increased in recent years as colleges charge more affluent students the full List Price in order to raise revenues to fund aid (and reduce Net Price) for other students. However, the use of financial aid at all but the most selective colleges has not been limited to students with financial need. Multiple researchers have documented increases in the amount of aid directed to high-income students as schools often use merit-based criteria rather than need analysis to award institutional aid.[5] As concerns grow about student affordability, more information is needed to judge the degree to which colleges are using institutional aid dollars to increase access for lower- and middle-income families.

The lack of solid evidence on the responses of colleges in terms of pricing is plausible for several reasons.

(1) Federal Aid Programs are Complex, and this makes it difficult for Colleges to identify which students benefit and take advantage of their increases in aid

The major federal aid programs, such as the Pell Grant, require a lengthy financial aid application and have stringent eligibility requirements regarding student need. Colleges have difficulty predicting which students are eligible for the aid beforehand, and identifying the students afterwards takes significant time and resources. In the case of the Higher Education Tax Credits, many students do not apply for financial aid, and so colleges do not know their family incomes to determine if they are indeed eligible for the benefit.

(2) Colleges that would theoretically have the largest incentives to raise tuition prices in response to the Higher Education Tax Credits enroll few tax beneficiaries

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[5] See the work by McPherson and Schapiro (1998), Ehrenberg (2000), and Horn and Peter (2003). The criteria used to define merit often favor students from higher-income backgrounds.

In the case of the higher education tax credits, the institutions with the strongest incentives to raise tuition prices are the community colleges. These institutions are most likely to charge less than $2,000, and so eligible students would be reimbursed as much as 50 to 100 percent for increases in tuition prices under the Hope Tax Credit. However, these schools predominantly serve low-income populations who are not eligible for the tax credit due to insufficient tax liability. Therefore, tuition inflation is an unlikely response to the credits.[6]

(3) Some of the Colleges with the largest tuition increases do not cater to students who receive significant aid benefits.

Although selective, private institutions have experienced some of the largest and most visible increases in tuition prices, these schools have few students who receive a Pell Grant or Higher Education Tax Credit due to the fact that the family incomes of their students tend to very high. Therefore, the growth in their tuition prices is unlikely to be linked to federal financial aid policy. At the opposite end of the spectrum, community colleges serve many government aid recipients, particularly low-income students who are eligible for the Pell Grant. However, these colleges have a mission of maintaining low tuition levels to maximize access. As shown above, the evidence suggests that even in the face of a large, transparent financial aid policy, they did not raise their tuition levels.

In summary, most studies have not found colleges to respond to federal financial aid policies by raising tuition prices. Studies that do provide some support for the notion are plagued by mixed and sometimes contradictory results or weak research designs. However, more information is needed on Net Tuition Prices and the use of institutional student aid, which are better indicators of the actual prices paid by students.

IF NOT DUE TO FEDERAL AID, WHY ARE COLLEGE PRICES INCREASING?

While responses to federal financial aid do not explain the growth in college tuition, there are many other factors that have been shown to be important determinants of college prices.

(1) Reductions in State Appropriations to Public Colleges and Universities

State appropriations play an important role in determining public college price levels as these funds have traditionally subsidized the costs for students at public institutions allowing them to charge in-state students a discounted price (Long 2004c). However, during the last several decades, state appropriations have not kept pace with inflation and/or growing student enrollments. As public colleges and universities have received

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[6] My research suggests that the primary beneficiaries of the higher education tax credits have been middle-income families. Most low-income families do not receive any benefit because they do not have tax liability, and the tax credits are not refundable. See Long (2004a) for more information. Kane (1999) and Cronin (1997) also note this concern in their work.

less support from the state, they have made up the difference by increasing tuition prices.

(2) The Increasing Costs of Faculty and Staff

A majority of faculty members and staff at colleges are now Baby Boomers nearing retirement age. As they aged and gained experience, they received the customary raises and are now near the peak of their lifetime earning trajectories. For this reason, the increasing cost of instruction and other expenditure categories involving staff, naturally increased. Also, with the elimination of mandatory retirement due to court action in 1994, faculty members may stay in a job longer and have become more expensive for colleges (Ehrenberg, 2000). Another source of increasing college costs is health care. The costs of providing health care benefits to faculty and staff have continually risen for colleges and universities, just as they have for other businesses and industries.

(3) The Rise of New Expenditures: Technology and Student Services

Colleges increasingly invest in costly technological improvements and upgrades both in the classroom and for research, and these have been costly. Also, in response to the demands of students, colleges are spending more on student supports such as academic and career services (Ehrenberg, 2000). At the extreme, some colleges have responded to students' demands for amenities such as state-of-the-art residences and gymnasiums. While the justification of these expenditures is much more controversial, , it is important to keep in mind that the bulk of institutions are not involved in such endeavors.

(4) The Growing Use of Institutional Financial Aid

As noted above, colleges are increasingly awarding financial aid to students. To fund these aid awards, colleges have increased list tuition prices and are in effect redistributing funds between students.

There is a great deal of diversity in terms of the finances of colleges, and it is difficult to discern whether each increase in expenditures is justified for educational reasons or questionable as an unnecessary expense. It is also important to note that all college students are subsidized by their institutions. With the exception of some for-profit colleges, **the tuition prices paid by students do not cover the costs of their educations.** Because no student covers their total educational costs with tuition, not even those paying the full list price without any financial aid, colleges must make up the rest of the cost with donations, endowment returns, grants, and by charging for the other services they provide.

RECONSIDERING FINANCIAL AID POLICY

Students have significant unmet financial need suggesting that federal student aid resources are critical to improving college access and success.

While the research on the behavior of colleges does not document major responses to federal financial aid, there is a great deal of evidence on the need for additional financial aid for students. Despite substantial increases in access to higher education during the last

several decades, postsecondary attendance in the United States continues to be stratified by family income. Among high school graduates in 2004, approximately 43 percent of students from families who made less than $30,000 immediately entered a postsecondary institution. In contrast, 75 percent of students from families who made more than $50,000 did so.[7] Recent analysis also documents significant unmet financial need among students.

Without sufficient financial aid, students are increasingly turning to high-interest credit cards and privates loans. They are also working significant hours, and this has been shown to impact academic performance and reduce the chances that a student will persist to college graduation. Given the critical role higher education plays in both individual economic success and the public good, increased support of college access should be a major goal of the federal government.

When designing an Aid Program, Information and Simplicity are Important

Several studies have found a significant lack of information on financial aid among prospective college students and their parents. Research by Kane and Avery (2004) demonstrates that low-income high school students have very little understanding of actual college tuition levels, financial aid opportunities, and how to navigate the admissions process. Other work has also found a significant lack of information among prospective college students in general (Ikenberry and Hartle 1998; Horn, Chen, and Chapman, 2003).

Another part of the problem is the complexity of the financial aid system. The federal application for financial aid is long and cumbersome. To determine eligibility, students and their families must fill out an eight-page, detailed form with over 100 items called the Free Application for Federal Student Aid (FAFSA). Not surprisingly, students and their families are often confused and even deterred by the form (ACSFA, 2005). The Commission on the Future of Higher Education, assembled by Secretary of Education Spellings, recently acknowledged problems with the current aid process. The Commission concluded that some students "don't enter college because of inadequate information and rising costs, combined with a confusing financial aid system." Perhaps due to the complexity of the system and the lack of information about the availability of aid, 850,000 students who would have been eligible for federal financial aid in 2000 did not complete the necessary forms to receive such aid (King, 2004). The FAFSA also serves as the basis to award most state and institutional need-based aid, and so it is a critical gatekeeper to most financial aid.

While the existence of aid programs was once thought to be enough to enable the enrollment of low-income students, clearly the visibility and design of the program also matters. Concerns about the low visibility of aid programs and the complexity of the aid process have spurred calls to simplify the form and enhance the visibility of aid programs. Research on examples of highly-publicized financial aid programs characterized as being simpler in design and application has found large enrollment responses. For example, Dynarski (2002) documents a large response when the Social Security Student Benefit (SSSB) Program was eliminated in 1982, and she attributes the large impact to its very simple

[7] Author's computations using 2004 October Current Population Survey.

application process and generous aid award. Another good example is the Georgia Hope Scholarship. Due to extensive advertising and the training of high school guidance counselors, nearly all students and families in the state quickly learned of the aid. Researchers have found that Georgia's program had a surprisingly large impact on college attendances rates (Dynarski, 2000; Cornwell, Mustard, and Sridhar, 2006). In summary, the research suggests aid programs are most successful when they are well-publicized and relatively easy to understand and apply for. This has also been found in the examination of other social welfare programs (Currie, 2004).

All Aid is not Equal: The Impact of Grants is different than Tax Credits or Loans

Support for grants, financial aid that does not need to be repaid, had not kept pace with inflation or rising tuition costs. In recent years, government policy has instead shifted towards supporting the Higher Education Tax Credits and the Federal Student Loan PRograms. However, these are very different forms of financial aid, and one should not expect them to have the same impact on college enrollment as grants.

My 2004 study of the Hope and Lifetime Learning Tax Credits shows that they did not increase access to higher education.[8] The main beneficiaries of the tax credits are unlikely to be students on the margin of attending college. Insufficient tax liability due to low income levels and the interaction of the credits with other aid programs prevents many low-income individuals from qualifying for a benefit. Moreover, the fact that students do not receive the tax benefit at the time tuition payments are due limits the effect the credits on college access and choice.

One should also be cautious about the movement towards student loans as the primary form of financial aid. Loans are a much more complicated form of aid, and there are many concerns that students and families understand little about debt. Unlike grants, loans could influence students' decisions during and after college enrollment, perhaps in negative ways. Researchers suggest that debt burden could significantly impact on a student's chosen field of study, and more narrowly, that loans could deter students from entering public service careers like teaching.[9] Another concern is the possibility that high student debt might encourage students to delay decisions like buying a house, getting married, and having children.

In summary, as policymakers consider financial aid reform, special attention should be paid to addressing the documented needs of students, simplifying the design of aid programs and the financial aid application (i.e. FAFSA), and focusing on grant programs rather than less effective and more complicated forms of aid, like tax credits and student loans.

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[8] See Long (2004a).

[9] Luke Swarthout, *Paying Back, Not Giving Back. Student Debt's Negative Impact on Public Service Career Opportunities* (Los Angeles: State Public Interest Group Higher Education Project, 2006).

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College Tuition Pricing and Federal Financial Aid: *Is there a Connection?*

Testimony before the
U.S. Senate Committee on Finance

Dr. Bridget Terry Long
Associate Professor of Education and Economics
Harvard Graduate School of Education

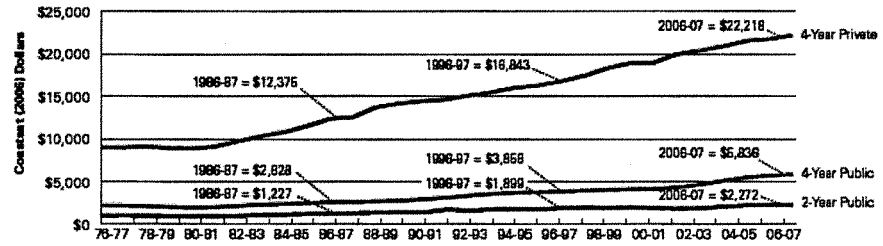
December 5, 2006

Do colleges react to increases in federal student aid and tax benefits by raising their tuition prices?

- *The Concern*: Because government aid enables students to pay more, it could also induce colleges to raise their tuition prices
- If true, this type of institutional response could diminish the overall impact of an aid policy by reducing the net discount a student receives.

→ Important implications for student affordability and whether tax dollars are being used effectively

How do we know if colleges are responding to aid by raising tuition?



- The fact that aid has increased at the same time as tuition *does not prove* that colleges have responded to Federal Aid Policy
- Are recent increases in tuition prices due to aid or other factors related to college costs?
- Must isolate the effect of aid from all the other factors that influence college pricing (a difficult task)

What does the Evidence say?

There is no "Smoking Gun" in terms of college pricing behavior.

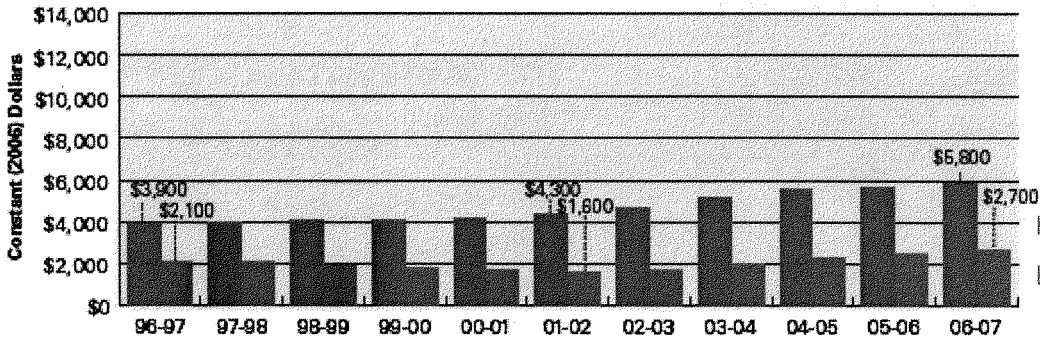
- Most studies find **little** to **no** response.
  - Long (2004)
  - Rizzo and Ehrenberg (2003)
  - Singell and Stone (forthcoming 2007)

- Studies that find some evidence for particular types of colleges are plagued by **mixed** and **contradictory** results or **weak research designs**
  - Long (2004): Inconsistent results
  - Singell and Stone (2007): Results appear attributable to other factors

The key outcome of interest should be Net Tuition Price (after financial aid)

Public Four-years: From 1996-7 to 2006-7

- Average *List* Price grew 49% to $5,800
- Average *Net* Price grew 29% to $2,700

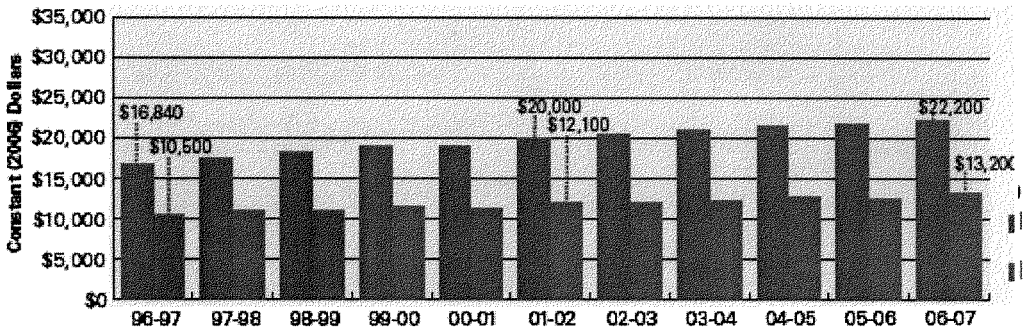


Source: College Board (2006). Constant dollars. Net price is calculated by subtracting average grant aid and tax benefits per FT student from the published price.

The key outcome of interest should be Net Tuition Price (after financial aid)

Private Four-years: From 1996-7 to 2006-7

- Average *List* Price grew 32% to $22,200
- Average *Net* Price grew 26% to $13,200



Source: College Board (2006). Constant dollars. Net price is calculated by subtracting average grant aid and tax benefits per FT student from the published price.

The Importance of *Net Price*

- A better indicator of the reactions of colleges to government aid policy
  - College could alter List Price *and* Institutional Aid awards in response to federal aid
  - McPherson and Schapiro (1991) found increases in government aid were coupled with *increases* in institutional scholarships at private colleges

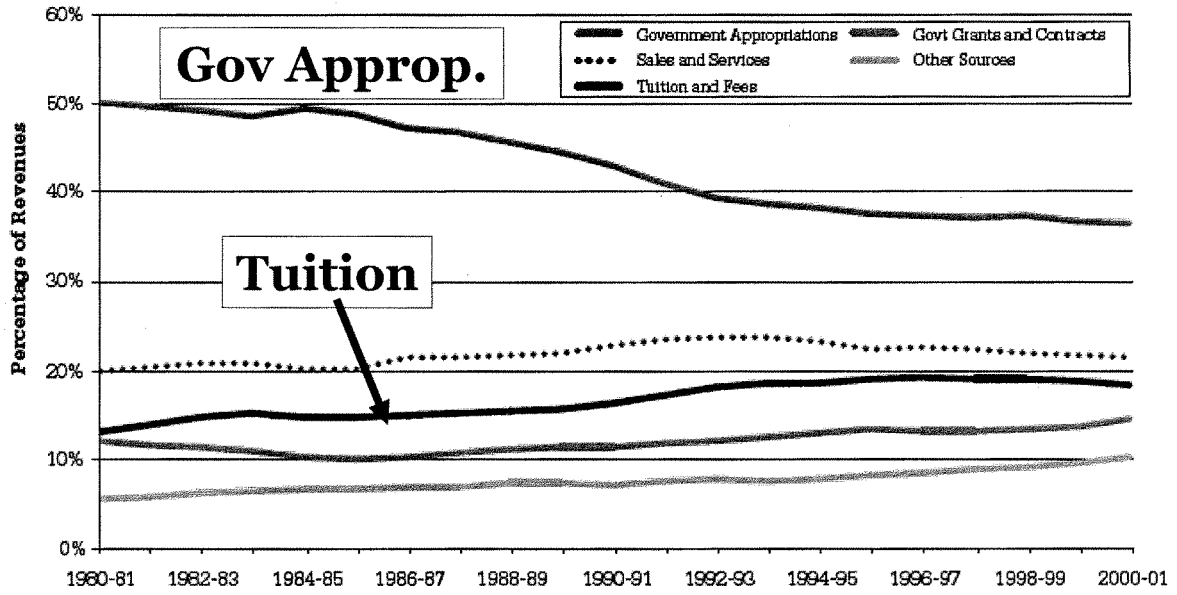
- A better sense of the costs students actually face
  → How are colleges using this money?

Why are College Prices increasing?

1. Reductions in State Appropriations to public colleges and universities

Reductions in State Subsidies

Revenue for Public Degree-Granting Institutions



Sources: *Digest of Education Statistics, 2002*, Table 328; 1995, Table 319; 1992, Table 313.
Enrollment in Postsecondary Institutions, Fall 2001 and Financial Statistics, FY 2001, Table 28, NCES 2004-155.

Why are College Prices increasing?

1. Reductions in State Appropriations to public colleges and universities

2. The Increasing Costs of Faculty and Staff
   - Aging labor force
   - Health care costs

3. The Rise of New Expenditures
   - Technology
   - Student Services

4. Growing Use of Institutional Financial Aid

Reconsidering Financial Aid Policy

- Students have significant **unmet financial need** suggesting that federal student aid resources are critical to improving college access and success

- When designing an Aid Program, **Information** and **Simplicity** are Important

- **All Aid is not Equal**: The Impact of Grants is different than Tax Credits or Loans

Questions for the Record

From Senator Baucus, U.S. Senate Committee on Finance

Response by Dr. Bridget Terry Long
Associate Professor of Education and Economics
Harvard Graduate School of Education

January 2007

(1) In your testimony, you discuss the net tuition prices students actually paid after receiving multiple types of financial aid and tax credits. Please discuss in detail how the timing of financial aid and credits could be optimized best to provide families the time they need to effectively plan ahead for college.

Planning for college should begin as early as possible. Research suggests that as early as fifth or sixth grade, students have already started to form opinions about whether they will be able to afford and attend college. Moreover, the courses they take in junior high or middle school serve as the foundation for the courses they will take in high school, and therefore, whether they will be adequately prepared for college. If students do not perceive that college is a possibility for them, then they will not take the necessary courses to make them eligible to continue. For these reasons, information about financial aid and credits should be provided to families *early* and *often*.

There are several possible ways to do this. First, the federal government could use information submitted to the IRS to calculate a projected financial aid amount. Using tax information, a preliminary expected family contribution (EFC) amount could be calculated and compared to financial aid eligibility. For example, families with a preliminary EFC less than $3,850 could be informed about their potential eligibility for the Pell Grant. One could imagine mailing families projections on their financial aid eligibility similar to the Social Security letters works receive annually.

A second way to do this would be to capitalize on the information the government has on assistance programs such as welfare (TANF), food stamps, and the free-and-reduced-price lunch. To qualify for these benefits, families have already proven that they are poor. The government could therefore skip the need for additional forms and inform these families by mail about their eligibility for financial aid.

Finally, some programs are available to all students, regardless of income. Information about Stafford Loans could be distributed to families while students are in junior and high school. Such literature could explain the difference between good and bad debt and the low costs of the loans. This information could be compared with the large benefits of getting a college education.

(2) Please comment on Dr. Dynarski's proposal to combine the Pell Grant and HOPE Scholarship/Lifetime education tax credits into one refundable education tax credit.

While the proposal would address some of the problems with complexity that currently plague the financial aid system, such a refundable education tax credit would *not* address the significant financial needs of many American families. It would not be a good substitute for the Pell Grant.

The goal of the Pell Grant is to give low-income families *immediate* access to capital to pay for college, and unfortunately, education tax credits do not also meet this need due to the timing of the benefit. Credits for higher education expenses in the current year do not accrue until the following year. Due to this timing, the delay between tuition payment and receipt of the tax credit could be up to 15 months assuming that tuition is paid in January of one year and taxes are filed in April of the following year. While a taxpayer could in theory spread the benefits of the tax credit over the year by changing the federal withholding amount from his or her paycheck, this is not realistic for most families, particularly low-income families. Moreover, changing the withholding amount would still not be sufficient to help most liquidity-constrained students pay their tuition bills, which are due at the beginning of the school semester or term.

The timing aspect of education tax credits differs greatly from most other forms of financial aid, which is realized at the time of attendance, and this feature has serious implications for the likelihood that the aid will influence families to attend college. If the primary reason individuals do not enroll in college is due to lack of funds, then the education tax credit will *not* help to increase college access. I have studied whether the higher education tax credits passed in 1997 (Hope and Lifetime Learning) increased college enrollment rates, and no effect was found.[1] This is most likely due to the fact that the credits do not help families *when* they need the money to pay their college bills.

On the other hand, a single refundable education tax credit would address other concerns. If designed to be a simple program, it could reach many families. As middle-income families have learned about the Hope and Lifetime Learning Tax Credits, they appear to increasingly be using the credit. However, it is important to note that these families would have probably sent children to college regardless of the credit. In this way, the tax credits address issues of *affordability* for children who would attend anyway, but the impacted population differs significantly from those who currently rely on the Pell Grant. Even if the higher education tax credits were to become refundable, the impact on low-income families would still likely be small due to the timing issue discussed above.

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[1] Long, B. T. (2004) "The Impact of Federal Tax Credits for Higher Education Expenses." In Caroline M. Hoxby, Ed. *College Choices: The Economics of Which College, When College, and How to Pay For It.* Chicago: University of Chicago Press and the National Bureau of Economic Research.

(3) In "Addressing the Needs of Under Prepared Students in Higher Education," you proposed that students who take remedial courses are more likely to complete a bachelor's degree within five years than those who do not take the courses. Taking this into consideration and the fact that students do not generally receive college credit for remedial course work, how does the need for students to take remedial courses affect the total cost students spend on college?

First, this conclusion focuses on marginal students – students who enter higher education under-prepared. My analysis with Dr. Eric Bettinger suggests that there is a benefit to having these students take remedial courses. The courses appear to give them the skills necessary to then persist and complete a bachelor's degree.

Undoubtedly, spending time taking remedial courses extends the time to degree and increases the total cost of college. Statistics suggest most students need only one or two remedial courses so the cost is not significant, particularly in the face of the potential benefits of the courses. However, among low-income students, who are likely to come from lower-quality high schools, the need for remediation is greater. Therefore, the neediest students are the ones most likely to suffer the additional costs associated with taking remedial coursework.

However, the social costs of not allowing students to take remedial courses are far greater. While long-term solutions may rely on changes in K-12 and reforms that better link high school and college, several present and long-term concerns must be considered. Unskilled individuals have substantial expenses associated with them such as unemployment costs and increased government dependency, crime, and incarceration. Moreover, the increasing demands of the economy in terms of skill encourage the nation to find an effective way to train its workers. As noted in a 2002 *Time* magazine article, eliminating remediation in higher education could "effectively end the American experiment with mass postsecondary education." Approximately 40 percent of first-time freshmen require at least one remedial course. The problem is a significant one, but doing nothing is a far more expensive option for the country.

TRINITY
WASHINGTON
UNIVERSITY
EDUCATION FOR GLOBAL LEADERSHIP

Testimony of
President Patricia A. McGuire
Trinity (Washington) University

Before the Senate Finance Committee
December 5, 2006

On the Announced Hearing Topic:

"Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail or Need Improvement?"

Trinity (Washington) University is pleased to be a part of Congressional history. Trinity Alumna Nancy Pelosi is about to become the first woman ever to be the Speaker of the House. We proudly congratulate this great Trinity Woman as she assumes the weighty responsibilities of the Speaker's chair.

Trinity in 2006 is a remarkably different institution from the historic Catholic women's college where Speaker-elect Pelosi graduated in 1962, and where I graduated in 1974. We continue our historic women's college, Trinity College, as the core of a larger, diversified university that also has coeducational units serving adult and professional students, teachers and principals. Most significantly, Trinity lives its historic mission of access for women with a clear sense of the social justice commitment we learned from our founders, the Sisters of Notre Dame de Namur.

Trinity today enrolls more District of Columbia residents than any other private university in the nation; nearly half (about 785) of our 1650 degree students are D.C. residents. Virtually all of these residents come from the eastern half of the city, fully a third from east of the Anacostia River in Wards 7 and 8. We are the only university offering a degree program east of the river.

Nearly 90% of Trinity's students today are Black and Hispanic, and more than 95% are low income students who receive substantial unfunded tuition discounts in order to attend Trinity—40% is our average full-time tuition discount. "Unfunded" means that we do not have endowment subsidizing these "grants"—this is lost revenue, amounting to nearly $4 million annually on our $23 million budget.

More than half of our students are eligible for Pell Grants. Trinity's full-time tuition is $17,700 this year, but I don't know of any students who actually pay that amount. After the Trinity discount, the Pell Grants, the D.C. Tuition Assistance Grants and other financial aid including loans, the typical full-time Trinity student pays about $2,000 or less out-of-pocket for remaining tuition balance and related non-housing expenses like books or transportation. That's still a great

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struggle for many of our students, particularly those from the eastern wards of D.C., most of whom are working 30-40 hours a week, even as full-time 18 year-old freshmen, in order to achieve their dream of a college degree at Trinity. The majority of these students have virtually no "expected family contribution" when financial aid calculations are done, and they are largely independent students even though they are of traditional college age. Many of these students also contribute to the support of their families, including, in some cases, their own children. But their desire for a college education is so strong that they are willing to work hard and make many sacrifices in order to stay in school and graduate.

Trinity's studies show that during the last five years 65% of our D.C. students are either still enrolled or have graduated, a remarkable rate of success in a city where completion rates are otherwise dismal.[1] A recent report by the D.C. State Education Office, funded by the Gates Foundation, hailed Trinity's success with D.C. students: "...the District should more proactively encourage increased D.C. student enrollment in colleges with a track record of success in serving low-income and minority students, including higher graduation rates...such as Trinity...."[2]

Trinity's endowment is about $10 million. That's five times larger than when I started in 1989, but still critically low. In my 18th year in office I am among the 27% of private university presidents with salaries below $200,000 (60% are below $300,000). I have the same fringe benefits as any other employee at Trinity. I own my own house and drive my own car to work. (I do get one extraordinary perk: an orange parking cone reserves my parking space near the front door of Trinity's Main Hall!)

I could work in many other positions and make a lot more money. So could all of my colleagues on the faculty and staff of Trinity. But we choose Trinity because we love what we do, and we are completely devoted to the success of our students.

We are not alone. The story I have just told you is repeated in various ways each day across the United States on the campuses of more than a thousand small private colleges and universities. We are the relatively obscure laborers in the vineyard, doing some of the most effective and creative educational work in this nation for new populations of students once excluded from higher education. You won't read headlines about us and our hedge funds—we don't have any! We spend our days worrying about how to find more support for our students, how to keep up with the insatiable demands for more technology and infrastructure improvements, how to ensure that our talented faculty and staff choose to remain devoted to the success of our students.

We worry about regulatory behaviors aimed at a very few very elite institutions that will have a much more harmful effect on us—Harvard will barely feel the pinprick of a policy action that could put us out of business, literally.

So it is with the whole concept of the tax exemption for institutions of higher education. When I read the headlines, I can well understand the Senate Finance Committee's concerns about a few institutions growing richer and richer each year, and a few presidents having extraordinary

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[1] For more on Trinity's success with D.C. students go to http://www.trinitydc.edu/dc/.

[2] "Doubling the Numbers: a Call for Action for the District of Columbia," D.C. State Education Office, October 2006. Available at http://newsroom.dc.gov/show.aspx/agency/seo/section/2/release/9956.

compensation. There are historical and competitive reasons for this on which I will comment momentarily. But as the old legal axiom says, hard cases make bad law.

In your effort to understand and construct policy for the very few very wealthy institutions in this nation, do no harm to the rest of us whose students need our good work and scarce resources, and who also need the ongoing support of federal financial aid in even more generous measure.

Incentivize good conduct for those with wealth, yes. But don't penalize the vast majority of smaller, less well-endowed private colleges and universities by tinkering with our tax exempt status.

The federal tax exemption for education recognizes the essential public good that schools, colleges and universities contribute to the nation; higher education is one of the drivers of economic productivity and lifelong economic security for citizens. In 2004, private colleges and universities employed nearly a million people nationwide, and had a cumulative impact of more than $340 billion on their local economies.[3] The public good provided by independent institutions is widely felt. Our colleges and universities not only spark economic development, but instill community service in students, and serve as centers of cultural, recreational, and social life in their neighborhoods. Even in a smaller institution like Trinity, our services for our neighbors are extensive; Trinity is one of the largest employers in Ward 5 in D.C., and our community relies on us for many services: employment, education, recreation for children and fitness opportunities for senior citizens, convening spaces, tutoring and other community service activities, and even security. Without our nonprofit status, none of this would be possible.

Moreover, the tax exemption is essential to enable donors to make charitable gifts that support scholarships and other needs of these institutions. Without the tax exemption, universities would lose significant charitable revenues, driving up the cost of tuition and potentially jeopardizing the very existence of the majority of the nation's 1600 private colleges and universities. Without these institutions, millions of students, many of whom are low-income minority students in urban private universities, would lose the support they currently receive to fulfill their dreams of intellectual and economic success.

1. Context and Scope

Harvard's endowment is extraordinary, yes. But it is just that—extraordinary—and not the right basis on which to make public policy. Putting Harvard into context:[4]

- For the end of fiscal year 2005, there were 1366 Title IV degree-granting private not-for-profit institutions that reported endowment data to IPEDS (Integrated Postsecondary Education Data System, the U.S. Department of Education's massive database of information about colleages and universities). **See the table below.**

- The median endowment (50% of schools below and 50% of schools above) for these institutions was $16.3 million.

[3] Data provided by the National Association of Independent Colleges and Universities (NAICU).
[4] Data provided by NAICU.

- Only 38 of these institutions reported endowments of more than $1 billion.

- None of the great universities in the District of Columbia has a $1 billion endowment—George Washington University has an endowment of $823 million, and Georgetown is $741 million, comparatively modest sums in light of the fact that these endowments barely match the size of the operating budgets for these institutions.

- Total U.S. post-secondary enrollment for fall of 2004 was 17.7 million students. Private not-for-profit enrollment was approximately 3.4 million students.

TABLE: 2005 Endowments of Private Colleges and Universities
(Source: IPEDS - U.S. Department of Education)

Number of Institutions	Percent of Reporting Institutions	Endowment Range (minimum)	Endowment Range (maximum)	Percent of Total Private Not for Profit Students Enrolled
683	50%	0	$16.3 million	26%
447	33%	$16.3 million	$100 million	33%
162	12%	$100 million	$500 million	20%
36	3%	$500 million	$1 billion	8%
38	3%	$1 billion	$26 billion (Harvard U.)	13%

Regarding the compensation of presidents: context is also important. Of 670 private colleges and universities listed in the 2006 presidential compensation survey of the *Chronicle of Higher Education*, 60% had salaries less than $300,000, and 27% were at less than $200,000. While a few individuals had extraordinary compensation, usually due to a deferred compensation arrangement, the mainstream compensation of college and university presidents is not out of line with contemporary norms for leaders of a wide variety of nonprofit institutions. Indeed, for many of us, our compensation is significantly less than the compensation of peers who are running nonprofit associations, foundations and other tax exempt organizations.

Also, regarding tuition prices, of 1200 private colleges and universities listed in the *Chronicle of Higher Education's* tuition survey,[5] the average tuition is $22,218 and the median tuition is $18,320. But given the prevalence of discounting tuition at private colleges, the actual cost to the student is much less, about $13,200.

Students attending private colleges and universities today receive *five times*[6] more grant aid from their own institutions than from the federal government. Nationwide, private colleges enroll proportionately at least as many low-income and minority students as public four-year universities, but they graduate from our institutions at a higher rate. Some of us actually enroll significantly more low-income students than our neighboring flagship state universities. A 1999

[5] Chronicle of Higher Education, November 3, 2006.
[6] NAICU data source.

Washington Post report[7] indicated, for example, that Trinity's median family income as $35,000 while the median family income at the University of Virginia was $94,000. The gap has only widened in recent years.

2. Wealth Creation Among Universities: Historical Notes

Some of the recent rhetoric around the wealth of Harvard and other elite universities, and their admission policies, makes it sound like all of this just happened. On the contrary, the historical roots of elitism and wealth among certain private universities are centuries-old.[8] Before the middle of the 20th Century, private higher education was largely the province of the Protestant aristocracy. Catholics, women, Blacks and other discrete social groups founded their own colleges because they were denied admission to the bastions of WASP privilege. Public higher education evolved differently, of course, but still, few working class students had the time or preparatory education to devote to higher learning.

Several landmark events in the mid-20th Century changed American higher education forever. Starting with the G.I. Bill in 1944, and later with the Higher Education Act of 1965 (and its many reauthorizations), deliberate public policy changed the whole idea of earning a college degree from a leisure time occupation for children of privilege to a necessity for preparing citizens of many ages and backgrounds for work. The G.I. Bill made adult education mainstream; the Higher Education Act emphasized egalitarian access rather than elitist exclusivity.

The Cold War, Sputnik and the Space Race all led to heightened awareness of the importance of higher education for the nation. The National Science Foundation grew out of this concern and poured millions of defense dollars into university laboratories and science faculties. The Civil Rights movement emphasized the creation of economic opportunity for all, and the Supreme Court and subsequent Civil Rights Acts enshrined this value in law. The Women's Rights movement emphasized the importance of including women in the mainstream of academic achievement, leading to massive coeducation, and Title IX enshrined this philosophy in law.

Meanwhile, the NCAA and television networks conspired to bring the names and athletic accomplishments of many universities into the living rooms of America, and over time Division I men's football and basketball became significant drivers of wealth and popularity for some institutions. The Bowl Championship Series and the Final Four became national sporting events of statures close to the Super Bowl and World Series.

All of this took place as the largest generations in the history of the world—the Baby Boomers, Generations X and Y, and the Baby Boom Echo—moved through school systems and on into college. The consumer movement that the Boomers shaped around almost every commodity had

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[7] Kenneth J. Cooper, "The Well-to-Do at the Public U; Increasingly Affluent Students are Choosing State, Not Private, Colleges," *The Washington Post*, November 25, 1999, p. A03.

[8] Consider the famous ruminations of Virginia Woolf in her 1929 essay *A Room of One's Own* as she compared the splendor of the mythical Oxbridge men's college with its "foundation of gold and silver" with the impecunious Fernham, the women's college, where "The amenities...will have to wait." (Virginia Woolf, *A Room of One's Own, 1929 Harcourt Brace, 1981 Harvest Paperback, pp. 10 and 20.)*

a tremendous impact on higher education, along with the sheer volume and great diversity of new higher education consumers that swept across the industry starting in the late 1960s.

Middle-class and upper-class consumers have played a significant role in shaping today's stratification of institutions of higher education according to wealth, prestige, amenities, access and affordability. Many studies document these phenomena.[9] Elite consumers seek out colleges and universities that enroll other elites, and they demand living and learning environments that satisfy their lifestyles and standards of living—hence, the proliferation of expensive new construction for residence halls and recreation centers on many elite university campuses. Robert Zemsky refers to the institutions that such consumers seek as "Medallion" institutions.[10]

Middle class families want to emulate the elites, but with more emphasis on value for the tuition dollars invested. Low income students and part-time adult learners want access, first, and affordability, also first; glitzy lifetstyle amenities, while important, can be traded for more affordable options that emphasize quality instruction and convenient schedules. All want the prestige of association with a good institutional name, but some are willing to pay much more for a famous name.

I have witnessed the sociological truths of American educational consumers intensely during my nearly two decades as Trinity's president. As low income Black and Hispanic women from D.C. and the close-in suburbs sought the benefits of a Trinity education in greater numbers, middle-class white students declined in number.

Race and social class are still large wedges dividing America's citizens and institutions, ensuring continuing segregation of low income minority students in relatively less wealthy urban schools while wealthy elites, predominantly white but more racially diverse than in previous generations, seek out, build and sustain the "Medallion" institutions. Notably, certain public universities—the "flagship" institutions—now join the Ivy League and a few other private colleges and universities as gathering places for the elites of American society.[11] Children from lower socio-economic strata, who are disproportionately Black and Hispanic, suffer in under-performing elementary and secondary schools where they do not receive the academic preparation necessary to gain entrance to elite colleges. The intersection of poverty, race and family cultures on the success or failure of children in K-12 education has been studied at length.[12] But, research aside, what's most obvious is that as children progress through levels of schooling, students with similar economic, academic and cultural backgrounds increasingly group together in the same institutions, with "diversity" for many elite schools becoming an elusive goal, or a curious experiment at the margins.

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[9] See Robert Zemsky, Gregory R. Wegner, William F. Massey, *Remaking the American University: Market-Smart and Mission-Centered*, 2005: Rutgers University Press.

[10] Ibid.

[11] See "Public Colleges as Engines of Inequality," *New York Times* Editorial, November 23, 2006. See also Danette Gerald and Kati Haycock, "Engines of Inequality: Diminishing Equity in the Nation's Premier Public Universities," The Education Trust at http://www2.edtrust.org/EdTrust/Press+Room/Engines+of+Inequality.htm.

[12] See the most recent excellent analysis of poverty, race and family conditions affecting educational attainment in the article "What It Takes to Make a Student" by Paul Tough in the *New York Times Magazine*, November 26, 2006, p. 44.

As these consumer trends evolved, several critical factors came together to create a "perfect storm" of opportunity for a few universities to become extraordinarily wealthy and remarkably selective: credit ratings, fund raising and commercial rankings.

3. Impact of Credit Ratings on Institutional Wealth and Prestige

Most college and university campuses are small cities with complicated physical and technological infrastructures. Many have buildings dating to the 19th century or earlier. Many also have buildings constructed in the bad architecture days of the mid-20th century, often with federal monies that are no longer available for projects like dormitories. 40 years later, most of these 1960s buildings are in desperate need of replacement.

Higher education has largely done a very poor job of explaining why our costs rise at a much greater rate than inflation, and, therefore, why tuitions often rise faster than inflation as well. The biggest drivers of costs at private colleges and universities are rising faster than *both* inflation and tuition. They include institutional grant aid, utilities, health care, property and liability insurance, library materials.

Facilities and technology are also significant drivers of the rapidly rising costs of managing our educational cities and towns. Here again, consumers—not just students, but also faculty and staff, and even neighbors who use our buildings and services—have certain standards that they expect to find when coming to work or sitting in class.

I have students, for example, who are stunned the first time they hear pipes clanking when we turn on our heat in Main Hall each fall, since they've never been in a place with a single-pipe steam heat system, a true relic of the 1800s. Faculty sometimes have a hard time being heard above the whine of window air conditioners in the summer. Staff in the dining hall serve three meals a day in the deep summer in stifling kitchen spaces built long before air conditioning was even imagined. I could easily spend $100 million in hidden infrastructure improvements.

Trinity is not alone; thousands of outmoded buildings remain operational on university campuses today. Many lack modern HVAC[13] systems, sprinklers, elevators and other functionalities that are today's necessities, not amenities, as new consumers bring ADA[14] and OSHA[15] issues, security, environmental and life safety expectations that modern risk management practices require us to anticipate. Insurance companies, knowing the risks of consumer expectations today, are also significant players in the ratcheting of costs-and-expectations for the new definitions of "basic" infrastructures. Even FASB[16] gets into it, adopting the FIN 47 rule that in 2006 now requires calculation of what can be a sizeable reserve on the balance sheet for the future liability of asbestos removal, even if the asbestos is currently encapsulated.

All of these issues drive infrastructure costs and lead universities to decisions about capital improvements through renovating, demolishing and adding buildings. Like other businesses,

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[13] HVAC = Heating, Ventilation and Air Conditioning Systems.
[14] ADA = Americans with Disabilities Act, guaranteeing access and equal treatment for persons with disabilities.
[15] OSHA = Occupational Safety and Health Act, protecting the safety of workers.
[16] FASB = Financial Accounting Standards Board that sets rules for accounting.

universities borrow money in order to support their capital needs. The credit rating business determines how much, and at what price, we will be able to borrow money.

Attaining and sustaining the best possible credit rating is one of the most important fiscal responsibilities of the leadership of any university. But the standards that Moody's and other credit rating agencies apply to determine the credit rating often work in conflict with other values that institutions might espouse, and that public policymakers might also consider very important. Perhaps the greatest irony in this entire conversation about the financial obligations of higher education is the fact that the most scrupulous discharge of the fiduciary duty of the president and trustees of the university might also offend public policy notions of affordability, access and fiscal restraint.

Consider this summary from Moody's 2006 Private College and Universities Medians:[17]

"Moody's 2006 private college and university medians support our ongoing stable rating outlook for the higher education sector. Key credit strengths include:

- *Continued strong student demand for private higher education, as evidenced by growth of median enrollment and strengthening student selectivity;*

- *Strong growth of net tuition per student supporting positive operating performance and healthy debt service coverage; and*

- *Positive investment returns and successful fundraising bolstering financial reserves.*

These credit strengths are offset by the following challenges:

- *Intense competition for students and research grants resulting in institutions increasing their spending on programs and borrowing heavily to invest in physical facilities;*

- *Moderately weaker balance sheets as strong investment returns barely keep pace with rapid debt increases; and*

- *Heightened external scrutiny of higher education tuition affordability raising concerns about future continued growth of net tuition per student."*

Note the last point. Moody's and other rating agencies place a great deal of emphasis on growth in net tuition, which is achieved through establishing the best possible tuition price and discounting as little as possible, which means that only those consumers who can afford to pay the high tuition will have access.

Moody's and other credit rating agencies take a very dim view of institutional practices that (a) repress tuition growth and (b) provide greater access to more needy students (who require larger tuition discounts). At Trinity, when we were in the process of securing our first-ever credit

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[17] All italicized quotations in this section taken from Moody's Investors Services, "Private College and University Medians 2006."

rating in 2002 (Bbb- from Standard & Poor's), we learned that our restrained tuition price and large volume of minority students (who are assumed to be very needy) would have a substantial negative impact on our ability to get a good rating.

Consider this statement from the 2006 Moody's Private College and University Medians:

"Aaa-rated colleges and universities (15 institutions) continue to demonstrate very strong student demand resulting in pricing power. Excellent freshmen selectivity (19% in fall 2005) and matriculation (60% in fall 2005) highlight that these institutions would likely be able to increase tuition levels, while maintaining strong student demand and stable enrollment." (page 6)

Moody's goes on to note:

"Despite their typically high sticker prices and pricing elasticity, all of these institutions have large financial aid and scholarship programs. Many of these institutions maintain a need blind admissions process, and some are committed to meeting demonstrated need of all admitted students. Some institutions have recently enhanced their financial aid programs in order to attract a more socio-economically diverse student body, by significantly reducing the level of parental contribution from families below set income levels. As a result of this tuition discounting, net tuition per student has grown at a slower pace than that of the other rating categories.

"Median net tuition per student of the Aaa-rated colleges and universities is a high $17,206 in FY2005, up 10% from FY 2001. However, Aaa-rated institutions depend on student charges, including tuition, fees, and auxiliary revenue, for a relatively small portion of their operating bases. Student charges represent a median 15% of operating revenue in FY 2005, compared to investment income (35%), grants and contracts (20%), and gifts (10%) which are more significant contributors of operating revenue." (page 6)

Note that Moody's does not look particularly favorably on the recent practice of some elite institutions of providing tuition-free education to students from families under a certain income level.

Moody's acknowledges the concentration of wealth in a very few institutions:

Wealth continues to be heavily concentrated in the higher rated colleges and universities, with the combined 63 Aaa and Aa-rated private universities (approximately 23% of the total portfolio) holding more than 80% of total financial resources. Strength of student market position and operating reliance on student charges also distinguish the higher and lower rated institutions. For example, Aaa-rated universities are highly selective (19% median freshmen selectivity in fall 2005) and depend on student charges for only 15% of operating revenue, compared to Baa-rated institutions, which accept a median 72% of freshmen applicants and rely on tuition and auxiliary revenue streams for 84% of their operating bases.

The problem is, of course, that in the world according to Moody's, the rich can only get richer—securing more debt to build more glamorous amenities to satisfy their ever-larger applicant

pools—while the rest of us put on a few more sweaters since our more limited borrowing capacity means we won't be replacing that old steam heat system any time soon.

4. Fund Raising

Fund raising, of course, also plays directly into the issue of credit ratings and wealth accumulation. Daniel Golden's book, *The Price of Admission*, provided me with several ruefully entertaining hours. His book amply illustrates the well known fact in higher education that elite families want to associate with other elites, and are much less likely to want to rub elbows with large numbers of students from other backgrounds. This tendency does drive big-time university fund raising, leading to the other well known fact that a very few institutions consume a significant amount of the charitable giving to higher education.

Moody's and other credit rating agencies also reinforce this behavior, since fund raising capacity is another one of their significant criteria. Simply put, the more likely it is that a university can raise significant amounts of charitable gifts, the better its credit rating and the more money it can borrow at lower cost, in order to provide even better amenities to an increasingly selective student body.

However, most institutions of higher education, including private colleges and universities, do not raise money in the manner described by Mr. Golden, or at the levels that a very few elite universities have sustained. In a study by the Council for Aid to Education, 20% of all universities received 75% of the charitable dollars—those were the research universities. Meanwhile, the much larger group of private master's universities and liberal arts colleges (427 institutions, or 42% of the group studied) received only 17% of the charitable dollars.

The tax exemption is essential to enable private colleges and universities to raise charitable gifts that support a sizeable amount of our service to our students and communities. Many students and families do not realize that the tuition they pay covers only part of the actual cost of the student's education, as little as 30% in some schools. Charitable gifts provide an important percentage of the operating costs at most institutions, through both direct gifts to parts of operations as well as endowment income.

At Trinity, for example, of the $23 million in revenues we expect this year in our operating budget, we plan on about $1 million (4%) in charitable gifts in our Annual Fund. We are more heavily tuition-dependent than many other institutions, about 80%, and this is considered a real liability by Moody's and other credit rating agencies. Nearly $4 million in gross tuition revenues is actually the unfunded discount we provide to the very needy students in our full-time College of Arts and Sciences. While we gross $9 million from that tuition line, we net only $5 million because of the discount. Because of this, charitable gifts are even more important to help ensure that Trinity can balance our budget each year. Balancing the budget is an important objective because we do have a $19 million bond, our full debt capacity, and we have to meet the covenants which include balancing the budget. The bank is not moved by our service to low income students; the bank wants to be sure we are able to pay off the loan.

Hundreds of institutions like Trinity serve critically needy student populations on campuses that have large infrastructure development needs. We must raise money to close the gap in our

budgets for the unfunded discounts, while also raising capital support for building improvements, faculty development, technological upgrades and similar projects that directly improve the quality of the student learning experience.

By tampering with the tax exemption for colleges and universities, Congress would undermine its own stated objectives of increasing access and affordability for citizens to obtain a college education. The Harvards of the world would be more than able to figure out creative ways to cope with such a loss, but institutions like Trinity would not be able to sustain their already-fragile business models in such an environment. The loss to hundreds of communities around the nation would be dramatic, as the jobs, goods and services provided by these smaller private institutions would evaporate.

5. College Rankings

Commercial rankings such as the *U.S. News and World Report* "Best Colleges" annual report are the other factor driving the accumulation of wealth and prestige among certain institutions today. Rankings are a dubious way for any student to choose a college, since these lists do not reflect much about the actual quality of teaching and learning on any given campus. But as a means to feed the American infatuation with prestige and fame, rankings have no equal.

Institutional wealth is the most important factor determining the *U.S. News* rankings. Faculty salaries, alumni giving, endowment-per-student and other indicia are all wealth factors. Moreover, much like credit ratings, *U.S. News* rewards institutions that do not enroll large numbers of low income minority students, since those students tend to have lower SAT scores and lower rates of retention and completion.

In spite of the obvious deficiencies of rankings, institutions of higher education and their various constituencies play the games with passion—at least those very few institutions on the top lists. Lost in the annual media frenzy over the lists is the fact that several thousand institutions on the lower tiers actually do a great job educating their chosen markets of students, often at much less cost and with many fewer resources than the large, prestigious universities.

Given our fundamental values of Freedom of Speech and Press, there's nothing that Congress can do about rankings—but understanding what they're really about, and how they influence institutional behavior for better or worse is important when considering policy alternatives. In fact, the great paradox of rankings is just like the paradox of credit ratings: presidents and trustees often consider it to be among their most important duties to improve institutional reputation, of which the rankings are a big part. Yet, in focusing on moving up in the rankings game, they often must take actions that seem contrary to public policy, e.g., limiting access for low income students so as to ensure good retention and completion rates.

6. What Can Congress Do?

Tinkering with the tax exemption for colleges and universities is the *last* thing Congress should consider in thinking about how to get the few relatively wealthy institutions to share their resources more equitably. For the vast majority of private tax-exempt American colleges and

universities, money is only an issue in its scarcity compared to the very large needs we are trying to serve.

Harvard can stand on its own sturdy legs to talk to Congress about its wealth and how to share it more equitably. But let's face it: even if Harvard were to raise the level of its "free tuition" largesse for families from the $50,000 family income to $100,000 or more, not that many more students would benefit, since so relatively few low-income students can perform academically at the elite levels expected at Harvard, Princeton and elsewhere.

In reality, these large social issues play out at much earlier places in the lives of students, in the failing urban public school systems and impoverished families where reading and academic success are not necessarily prevalent virtues. There are many institutions of higher education like Trinity who consider it a profoundly important mission to educate such students, and we are privileged to welcome them to our campuses. The real challenge is how Trinity and institutions like us will be able to continue to provide the affordable access and substantial support services like tutoring and academic support that we currently provide to low income students even as our critical institutional needs for infrastructure improvement loom large.

For starters, thousands and thousands more low-income students nationally will benefit if Congress in its wisdom will increase the maximum Pell Grant, which has not grown for five years from its current level of $4050, as well as continue to strengthen other vital federal financial aid programs.

In the same way, middle-income families will continue to need the support of tax incentives to help offset their college expenses. Student loan interest deductions, HOPE and Lifetime Learning tax credits, 529 plans, and tuition deductions help middle class families pay for college at every stage of the financing pipeline. The 529 plans allow families to save for their children's education when they are young. Tax credits and deductions help ease tuition payments while students are in college. And the student loan interest deduction gives graduates getting started on their careers a break in paying back their college loans.

When the federal government helps students pay for college, it invests in our nation's future. A college education benefits not only the individual, but society as a whole. A highly educated work force has become an essential component of economic growth and competitiveness. It is estimated that increases in national educational attainment have accounted for almost 30 percent of the growth in national income this century. Because they earn more, save more, and are unemployed less frequently, college graduates make fewer demands on the public purse and pay more taxes.

Some critics have said that increases in federal student aid encourage colleges to increase tuition. The congressional education committees have asked the Department of Education to study this very question several times over the past few years. Consider these findings of the studies:

- ✓ **Study of Costs and Prices** (2001): *Regarding the relationship between financial aid and tuition, the models found* ***no association*** *between most of the aid variables (federal grants, state grants, and student loans) and changes in tuition either in the public or private not-for-profit sectors.*

- ✓ **The Impact of Federal Student Financial Assistance on College Tuition Levels** (1997): *Federal assistance **is unrelated** to private college tuition. Among private 4-year colleges, federal student aid changes **have stimulated** the provision of **additional institutional assistance** and have not replaced existing forms of aid.*

- ✓ **Issues of Cost and Price in Higher Education** (2001): *There is little evidence—and little theoretical evidence to suppose—that federal student aid increases have contributed to tuition inflation."*

The research shows that there is no association between federal student aid and increased tuition. In fact, recent state budget actions show that cuts to student aid lead to tuition increases. For example, when states cut funding for higher education, tuition at state colleges and universities increased rapidly. Private colleges and universities have increased their financial aid budgets significantly to make up for the loss in the value of federal student aid over the last 5 years.

Yes, low-income and middle-class students deserve as much access to excellent higher education as their elite peers at very prestigious, wealthy institutions. For that very reason, Congress needs to stay focused on the needs of these students, and not get distracted by the very few institutions whose wealth or compensation policies snag headlines. In expressing concern about the few, Congress should not miss the bigger story about what's right in higher education among the thousands of modestly-resourced colleges and universities that do their work well each day without much notice or glamour or exceptional charitable gifts.

I urge the Senate Finance Committee to continue to exercise its customary extraordinary care in distinguishing the unusual stories of the elites from the mainstream needs of the majority of the 17 million students currently enrolled in colleges and universities all over this great nation.

Thank you for considering this testimony.

TRINITY
WASHINGTON
UNIVERSITY
EDUCATION FOR
GLOBAL LEADERSHIP

August 21, 2007

To: United States Senate
Committee on Finance
Washington, D.C.

Fr: President Patricia McGuire
Trinity (Washington) University
Washington, DC

Apologies for my delay in response.

Below are my answers to the questions posed by Senator Baucus concerning the testimony I gave in December 2006 on higher education costs and finance. Please contact me if you need any further information.

1. *In your testimony, you stated that Trinity (Washington) University is discounting the $17,000 cost of tuition for full-time students. Please discuss how Trinity is helping students pay for tuition.*

Trinity provides a number of sources of financial assistance to students, including:

- On average, Trinity provides an institutional discount to approximately 90% of all full-time undergraduates, and this discount is about 40% on average. Trinity's endowment is quite small, only about $10 million, so the discount is largely "unfunded" meaning that there is no money backing the discount.
- Trinity's total discount volume in 2006-2007 was about $3.6 million on gross full-time undergraduate tuition volume of $8.9 million.
- Nearly 60% of Trinity students receive Pell Grants.
- Nearly 50% of Trinity undergraduates are D.C. residents; 65% are African American and 12% are Latina.
- Trinity students who are D.C. residents are also eligible to receive a $2500 D.C. Tuition Assistance Grant and additional grants from the D.C. College Access Program. Trinity works with these grant sources to be sure that every eligible student takes full advantage of these programs.
- With the Trinity discount of about $7300, the Pell Grant at $4000, the D.C. TAG Grant of $2500, and a D.C. CAP Grant of varying amounts, along with some Federal Work Study money, the average low income D.C. student at Trinity might have a final bill of no more than $2000 (some even less) that can be covered with loans.

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(Please note that Trinity's full-time undergraduate tuition in 2007-2008 is $18,250, and the discount proportion remains the same.)

2. Please discuss the workforce education programs that Trinity offers for non-traditional students.

Since the middle of the 1980's, Trinity has offered undergraduate and graduate programs for working professionals in the Washington region, with a clear emphasis on working women. The primary programs of interest to these students are Business Administration, Human Relations and Communication. Trinity added Nursing in 2006, and intends to develop more programs focused on preparing Health Care professionals.

Trinity's tuition price for undergraduates in these programs is significantly less than many area universities. Instead of discounting, we just set the per-credit-hour tuition at a lower level for working adults. Undergraduate per-credit-hour tuition in the School of Professional Studies is $465 (compared to the $590 per credit hour tuition in the full-time College of Arts & Sciences.)

In 2005 Trinity became the first university in the Washington area to offer a degree program east of the Anacostia River in the Parklands community of southeast Washington, at a location known as THE ARC (Town Hall Education, Arts and Recreation Campus). Trinity offers an Associate of Arts degree program at THE ARC. Tuition for this program is just $150 per credit, reflecting Trinity's sensitivity to the low income population served in Wards 7 and 8 of the District of Columbia.

Trinity's program at THE ARC will expand in future years to include baccalaureate and master's degree courses, since many of the residents of that neighborhood have expressed a clear desire to continue advancing through the educational levels. With such advancement they also realized promotions at work and enlargement of their career opportunities.

3. Please comment on Dr. Dynarksi's proposal to combine the Pell Grant and HOPE Scholarship/Lifetime education tax credits into one refundable education tax credit.

While this proposal may appear to some to be interesting on the surface, in fact, in terms of meeting the greatest need for financial aid among low income populations, the proposal is largely irrelevant. A tax credit may be an exciting idea for middle class parents, but for a low income student who is *de facto* independent and struggling to earn enough money to pay her college bills on her own, without parental support, the concept is entirely foreign and unhelpful. She needs immediate cash to pay her tuition bill and buy books. The tax credit would not become real cash until well past the time of her financial need, and only if she files a tax return.

The best thing Congress can do to help low income students obtain a college education is to increase the Pell Grant annually to keep pace with the cost of living.

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Statement of Senator Gordon H. Smith
Hearing before the Senate Finance Committee

The Importance of Ensuring the Opportunity for an Affordable College Education for Lower and Middle Income Americans

A college education has never been more valuable and important than it is in America today.

Unemployment statistics demonstrate that people with a college degree have an easier time finding and keeping jobs than those without one. Although the national unemployment was low (i.e., 4.4%) in 2005, workers who did not graduate from high school had a higher unemployment rate of approximately 8.8 percent. American workers with a high school degree had a 5.4% unemployment rate, those with some college had a 4.2% unemployment rate, and those with at least a bachelor's degree only had a 2.3% unemployment rate. We need to do more to reduce the unemployment rate for all Americans whether they have a college education or a high school education.

In addition to employment rates, it is also well known that the level of educational attainment has a tremendous impact on earning potential. Today, individuals between the ages of 25 and 34 and who have a college degree earn $13,900 more per year than their counterparts with a high school diploma. This earning gap only increases over time; those between the ages of 45 and 54 with a bachelor's degree earn $22,900 more per year than those who completed only high school.

College graduates also enjoy benefits beyond increased income. Research has shown that college graduates have higher levels of saving, increased personal and professional mobility, improved quality of life for their offspring, and better consumer decision making.

However, while a college degree is more important than ever, it is becoming harder for many people to attain due to ever increasing tuition costs. At public four-year colleges, tuition and fees have gone up 35% in the last five years, even after adjusting for inflation. Currently the average tuition and fee charges at public four year colleges are $5,836--up 6.3% from the previous year.

It is for these reasons that I have introduced legislation with my colleague, Senator Bingaman, to increase the affordability of higher education, particularly for community college students. S.1697, a bill to Reform Hope Scholarships and Help Community College Students, would amend the tax code to allow the Hope Scholarship Credit to cover fees, books, supplies, and equipment. It addition, the bill would exempt Federal Pell Grants and Federal supplemental educational opportunity grants from reducing

expenses taken into account for the Hope Scholarship Credit. Such a bill would be helpful in that less than one-fifth of all full-time community college students received the maximum Hope Credit.

Similarly, my colleague Senator Lincoln and I have led a bipartisan effort to broaden and increase existing educational tax incentives by introducing S. 3940, the Educational Opportunity and Affordability Act of 2006.

This bill would among other things: increase the number of elementary and secondary school teachers eligible for the classroom tax deduction; allow the Hope Scholarship Credit for the first three years of postsecondary education; increase the employee tax exclusion for employer-provided educational assistance; and increase the tax deduction for student loan interest.

I look forward to continuing to work on these important with my colleagues in the 110th Congress in an effort to make a quality college education available and affordable to all.

COMMUNICATION

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December 1, 2006

The Honorable Charles E. Grassley
Chairman
Senate Finance Committee
219 Dirksen Office Building
Washington, D. C. 20510

The Honorable Max S. Baucus
Ranking Member
Senate Committee on Finance
219 Dirksen Office Building
Washington, D. C. 20510

Subject: Tuesday, December 5, 2006, "Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail, or Need Improvement?"

Dear Senator Grassley and Senator Baucus:

I commend you both on asking the questions for this hearing. Creating a workforce for the 21st Century depends on revision of this situation. I have been Chief Financial Officer of a Carnegie 1 Research University. Every day in the mail, I receive solicitations for money from my schools, Williams College and Yale University.

Students I know and tutor at Bunker Hill Community College in Boston, trying to enter the workforce as professionals, have little chance of finishing their degrees because they lack hundreds of dollars for small tuitions. Many of these students are denied Pell Grants due to supposed shortages of funds at the Department of Education. Tax policy now places a higher priority for the nation on the indoor golf nets, built with tax-deducted dollars, at Williams College than a Pell Grant for a community college student.

I submit here for the Committee my paper for the Center for College Affordability and Productivity. Modest modification of tax policies on donations and on endowments can create nearly two million new Pell Grants. In this time of need for so many low-income students, are many universities and colleges taking more than their fair share of federal resources?

An example: Columbia University has just announced a $1 billion raid – 246,913 Pell Grant -- raid on the U.S. Treasury. By calling the raid a $4.3-billion capital campaign, Columbia may proceed without further permission. Yet Article 1, Section 8 of the U.S. Constitution gives Congress to determine spending for "the common Defence and Welfare of the United States." Surely, Alexander Hamilton did not imagine that his own Columbia would usurp the federal government powers in this manner.

Yours,

James R. W. Sloane, by e-mail here.

The Center for College Affordability & Productivity

U.S. Tax Policy, Research Grants and Higher Education: The Undebated Billions

by Wick Sloane, Research Fellow & Jonathan Leirer, Research Assistant

Columbia University has announced a $1-billion—or 246,913 Pell Grant—raid on the U.S. Treasury. Cornell University has also joined the game, taking away another $1 billion dollars in possible taxes. These raids have the blessings of the Secretary of the Treasury, of both Houses of Congress, and of you and me.

By titling the raid a "$4 billion capital campaign" Columbia and Cornell can proceed without further approval. In principle, Columbia will take $4 billion off the taxable income of the donors. In a conservative estimate, this translates into at least $1 billion less federal taxes collected.

This paper asks why, in seeking funds, the public debate omits the substantial subsidies from our current federal policies on taxes for education and sponsored research. The issue is not that we are reaching the wrong decisions on allocating resources, but we are not even talking about the right questions.

Founded in 2006, The Center for College Affordability and Productivity (CCAP) is dedicated to research and recommendations on the issues of rising costs and stagnant efficiency in higher education, with special emphasis on the United States. The Center is an independent nonprofit based in Washington, DC.

CCAP's founder, Richard Vedder, is a distinguished Professor of Economics at Ohio University. He is the author of several books, including *Going Broke by Degree*, and (with Wendell Cox) the forthcoming *The Wal-Mart Revolution: How Big Box Stores Benefit Consumers, Workers, and the Economy* . Dr. Vedder earned his PhD and MA in Economics from the University of Illinois.

Bryan O'Keefe, CCAP's Executive Director, has written for many publications on education and on labor. A graduate of George Washington University, O'Keefe is a founder of *The GW Patriot*.

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Perspectives on Higher Education

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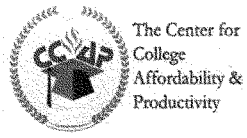

U.S. Tax Policy,
Research Grants and Higher Education –
The Undebated Billions

Wick Sloane, Research Fellow
and Jonathan Leirer, Research Assistant

Columbia University has announced a $1-billion – or 246,913 Pell Grant – raid on the U.S. Treasury. Cornell University has also joined the game, taking away another $1 billion dollars in possible taxes. So have the University of Virginia and Yale which are in for $3 billion each. A $5 billion drive by Harvard is said to be in the wings. These raids have the blessings of the Secretary of the Treasury, of both Houses of Congress, and of you and me.

By titling the raid a "$4 billion capital campaign", Columbia and Cornell can proceed without further approval. We, the people, have deemed contributions to such campaigns are deductible from our income taxable by the Internal Revenue Service. In principle, Columbia will take $4 billion off the taxable income of the donors. In a conservative estimate, this translates into at least $1 billion less federal taxes collected.

This $4 billion, along with the $25 billion generous people donate to U.S. colleges and universities each year, is not on the policy tables as the nation, again, has frozen Pell Grants at a maximum of $4,050 per year. That's less than an Ivy League meal plan. Pell Grants are a major funding source for low-income students trying to complete college.

With the report in September from the federal Commission on the Future of Higher Education (Spellings Commission) comes a recommendation to increase Pell Grants. Even state college tuitions average now $5,800 (College Board, 2006 report).

Higher education leaders are already lauding the proposed increase and pressuring the federal government to find the funds. This places the burden of the solution on the government, absolving higher education of any independent action. What higher education is hiding from the public is the array of federal funding beyond the federal Department of Education.

A modest proposal: How could the US increase Pell Grants without increasing spending? Answer: Start the discussion by putting 2,043,407 (Table 1) new Pells on the table, from credible modification of current tax policies. As of 2004, the U.S. spends $12 billion dollars on Pell Grants, from total Department of Education higher education discretionary funding of $16.5 billion.

Table 1: Found Pells

Modify donations tax policy	981,481
Cut Research Overhead by 50%	951,852
Taxing Elite Subsidy as Income	44,444
1% Endowment Income Tax	65,629
	2,043,407

This paper asks why, in seeking funds, the public debate omits the substantial subsidies from our current federal policies on taxes for education and sponsored research. The aim of this paper is to open the debate on the magnitude and use of total federal funds now available for higher education. To put it differently, we are trying to expose some disconnects in our national assumptions about education.

Analytic Frame

Federal tax policy, via tax-free endowments, tax-deductible gifts, and research funds, provides substantial subsidies to U.S. higher education, public and private. The question is not whether this is good or bad public policy per se, but rather why these policies receive scant review, alongside other federal appropriation and budget spending decisions for the Department of Education.

The web of federal policies regarding higher education is complex. Many small unrelated decisions and details add up to a massive investment of which the Department of Education is by no means the largest. And funding also comes through unrelated agencies ranging from the National Endowment for the Arts to the National Institutes of Health and the Department of Defense.

In addition to this funding, unexamined policies allocate billions in public capital to higher education, public and private. This paper uses Pell Grants as an example of an often-identified shortage. How many Pell Grants could be created with alternative policies regarding the tax treatment of gifts to higher education? The point is to illustrate the magnitude of resources that could be on the policy table, *not* to evaluate the effectiveness of Pell Grants or even advocate an expansion of that program.

This paper looks at higher education in the context of federal non-profit status, which governs donations, endowment income, and tax status. Private universities and colleges hold this status. Public colleges and universities are often state agencies with fundraising and endowment arms set up as independent nonprofits. The following discussion could apply to all non-profits falling one way or another under federal 501 c 3 tax status, ranging from hospitals to museums and orchestras.

Current U.S. Education Policy and Plan

Amidst the Spellings Commission discussions and all the debate in recent years is always the question of whether the U.S. should have a national higher education policy at all. Seldom stated is that the U.S. already has national policy, legislated and codified and in force, on higher education. This policy was not consciously set in a coherent fashion based on a consensus educational policy, but rather was backed into in a series of policy actions over the years, but nonetheless, a policy it is.

Our national policy is to believe that the Founders, who didn't mention education in the Constitution, left higher education to the states. This ties the hands of anyone trying to devise a national higher education policy. Our current national higher education policy seems to be that we will ignore the poor. Our national policy is to let Medicaid and rising medical costs crowd higher education out of state budgets. We know this, yet we don't have a plan. Our policy is to leave the problem to strapped statehouses. Our national policy is to wring our hands about a lack of budget and appropriations for federal student aid while giving away the store through the back door, with federal tax policy and current methods of research funding.

Federal Tax Policy on Donations and Endowments

Generous donors gave $25.6 billion to colleges and universities in 2005. (Council on Aid to Education.) Under current federal tax policy, these are tax-deductible dollars. Current policy makes no distinction on the uses of the gifts. Athletics, new buildings, and scholarships, for example, have equal deductibility rules. At least $295 billion in U.S. college and university endowments (NACUBO 2005) earn income that current policy exempts from federal taxation. That policy makes no distinction in the relative wealth of the college – endowment per student, for example, or in relation to operating budget. The implications of both policies are substantial. (Table 2)

Table 2: Policy Effect for Donations and Endowments

Annual donations	$ 26,500,000,000
(2005 CAE)	
Tax rate	30%
If same amount not donated, taxed as income.	$ 7,950,000,000
Change Tax Policy by	
50%	$ 3,975,000,000
Full Pell Grant	4,050
New Full Pells Available	981,481
Estimated Higher Ed Endowments (NACUBO 2005)	$ 295,332,375,000
NACUBO Average Rate of Return	9%
Annual Income	26,579,913,750.00
Tax Rate	30%
Foregone Tax	$ 7,973,974,125
New Pells Available	1,968,883
New Pells Available at tax of:	
1%	65,629

We will illustrate by picking on the schools attended by the senior author, Williams College and Yale. The implied federal tax subsidy, via tax policy, at these schools, is $30,000 to $41,250 per student. (Table 3) This at least three times the full cost per student at a community college. Or about seven to nine full Pell Grants at current funding levels. Take the untaxed endowment income of those schools and then the forgone tax revenue from tax-deductible donations. Divide that by the number of students. While one can quarrel over methodology (e.g., even the definition of students), the per student funding by any calculation is very large.

Our national policy, then, is that the indoor golf driving nets at Williams, built with tax-deducted dollars, are more important than Pell Grants for community college students. The problem is even more pronounced when these large gifts are specifically targeted for athletic programs and facilities. Should million dollar skyboxes at football stadiums really receive the same tax emption as money donated to the school library? Rep. Bill Thomas (R-CA) is asking that question, but few others are (and, unfortunately, Rep. Thomas is retiring at the end of this year). Should a dollar in Williams' current $400 million capital campaign be worth the same deduction as a dollar to Friends of The Library at Bunker Hill Community College?

Table 3: Individual College Example

Williams College Example			
Endowment	$ 1,500,000,000		
Estimated annual return, untaxed		10%	
		150,000,000	
Reasonable Tax Rate		30%	
Foregone Tax	45,000,000		45,000,000
Annual donations			
From 2004 990	50,000,000		
		30%	
Foregone tax	15,000,000		15,000,000
Total Annual Forgone Tax			$60,000,000
Number of students		2,000	
Annual tax subsidy per student			$ 30,000
At Endowment return of		15%	$ 41,250

What is the total impact of the golf nets and the $26.5 billion donations in federal tax deducted dollars, to colleges and universities? Assume a 30% average tax rate for the donors. This policy results in $7.9 billion in forgone tax revenues. As context, remember that total 2004 federal discretionary spending from the DOE on higher education was $16.5 billion, including $12 billion for Pell grants. So the implicit "tax expenditure" from these tax policies is to reduce possible discretionary spending on higher education in the U.S. Department of Education by close to 50 percent.

The current tax policy does not distinguish between the gift for the golf nets and a gift for a scholarship or for faculty salaries. Different institutions have different needs and few are as wealthy as Williams. None of the current debate on higher education, in the recent Spellings Commission, or in trade groups, including student associations, has this $7.9 billion from tax policy on the table.

We do *not* make the assumption that more money is the solution for educating more people. But under current policy, neither higher education leaders, nor anyone else, have any idea of the magnitudes or the effect of the current public capital allocated to higher education. However, there is good reason to believe that more money under current rules ensures raising tuitions (Vedder 2004). The policy Holy Grail is to improve student aid without the croupiers at the colleges and the universities raking in the new money to meet new self-created costs.

College Admission and Lottery Winnings

Tax policy also figures into rising tuitions. Many colleges dismiss public criticisms of tuitions of $30,000 and more, arguing that the cost per student is higher than what's called the "sticker price." Yale or Stanford, for example, have full tuition, room, and board at more than $40,000 per year. This is cheap, the explanation goes, because the cost per undergraduate is closer to $80,000. Income from endowments and from donations makes up the difference, $40,000 a student or even sometimes more. Gordon Winston of Williams College, arguably the dean of higher education economists, notes that this is evidence that the elites are, in effect, paying for talent through this endowment/gift subsidy. (Winston, 2000)

As a national policy, generated through tax-exempt dollars, the question is whether that benefit should be taxable. Since a large portion of students at elite universities like Williams and Yale come from upper income families, current tax policy favors this group rather than those coming from more modest backgrounds. In a fundamental sense, this is the equivalent of a highly regressive tax that soaks the poor relative to the rich.

A family with an income of $250,000 at Princeton receives that large $40,000 subsidy, the same as a family with income of $40,000. Current tax laws permit this. What's the difference, though, between this income and other in-kind benefits that are taxable? Why not take this subsidy to the elites and count it as taxable income to the

family? Remember, the decision not to do so reduces federal revenues that might otherwise go to Pell Grants. (Table 4)

Table 4: Effect from Untaxed Cost Subsidy

Williams and Ivy Example		
Annual Undergrad Cost	80,000	
Annual Full Tuition	40,000	
Untaxed Benefit	$ 40,000	
		30%
Foregone tax	12,000	
Total, with 1,000 at full tuition 1,000		
Students	$ 12,000,000	
New Pells per school		2,963
	15	
For 15 Ivies, Elites	44,444	

At a job, subsidized parking and some expense allowances are a taxable benefit, as is going on vacation on the corporate jet. These fall within employment relationships, though, while attending Yale or Williams is not. The benefit is exclusive to a lucky few. Given the nature of admissions at elite colleges, why not tax the differential as lottery winnings? (26USC3402(q))

Federal Research Funding In Higher Education

The federal government spends at least $25 billion per year funding independent research, mostly at universities. The situation is complicated. For example, these funds are dispersed at the expense of those without time or lobbyists.

Federal Office of Management and Budget Circular A-21 (Revised 05/10/04), available on the Web, is the 36,000-word (downloadable at 123 pages) rulebook on grant funding. The funding arrives at universities in two forms: direct research funding and indirect-cost reimbursement, known in lay terms as overhead. A scientist seeking to turn lead into gold would write a research budget covering the project costs, excluding items

such as heat, light, electricity, the building -- the overhead. Say the scientist has a budget of $100 for his costs. The cost to taxpayer would be $100 plus the overhead that the particular university has negotiated with the federal government. This can range from 30% at a public university to more than 50% for the Ivy League. This is not a typo. Understanding and negotiating a nuclear arms treaty would be simpler than doing the same thing with federal research awards to a university.

The basic formula is the ratio of what the university spends to support research – buildings and all – divided by the total research funding the university receives. The original notion was to provide incentives for universities to invest in research. Fair enough. The situation has no cap and no scrutiny beyond the insiders. Basic math skills illustrate that the more that is spent on research, the higher the reimbursement percentage. In short the formula is an invitation to spend, not conserve resources. The incentive exists to spend money because the federal government will repay.

These funds do support scholars and often provide students with work that enhances their own education. Legions of lobbyists and university staff labor to bring these grants to their particular universities. Higher education does a poor job explaining the impact and implications of these research programs. These funds are the apples to the oranges of, say, teaching solid writing, thinking and problem solving skills to a community college student. The national debate too often swirls all this together, with no explanation of how university funding might go up while undergraduate aid goes down. The value of research versus undergraduate aid is an important debate – yet it is not discussed, in some cases no doubt because the prestige research universities do not want this information widely dispersed or a national dialogue on the research/teaching tradeoff.

The students and families looking at frozen Pell Grants, however, might look at opulent new laboratories and golf nets, and wonder about overhead charges that often exceed 40%. Higher education may be the only industry that regards overheard expenses of more than 15% acceptable. Higher education leaders howl that any tampering with research will undermine the economy and the strength of the nation.

Undebated policy questions are at least two. What about capping overhead at 15%? That could fund 951,852 Pell Grants! (Table 5) Then, what if five percent of health research, say from heart disease or lung cancer, shifted instead to community college workforce readiness – creating a 21st Century workforce, with high math skills. Would lifetime health costs to the government come down? It's a question worth exploring. The issue is *not* that we are reaching the wrong decisions on allocating resources, but *we are not even talking about the right questions.*

Table 5: Effect from Federal Research

2004 R & D Funding	$	25,700,000,000
Estimated Overhead Rate		30%
Amount spent on overhead	$	7,710,000,000
Cut Rate in Half to 15%		50%
	$	3,855,000,000
Current Full Pell Grant	$	4,050.0
New Pell Grants		951,852

So What? Why Focus On A Few Wealthy Institutions?

For better or worse, the elite universities set the pricing policies for the nation. A price hike in New Haven always finds its way to a community college in Iowa.

Put in terms of current performance measurement, if all the top colleges and universities are producing leaders with a responsibility to the public good, why is U.S. public education such a mess? The probable reply from the elites: "That's not our mission".

Again, so what? Through student loans, Pell Grants, research grants, and tax benefits, the elites receive billions per year in federal benefits. The avowed purpose of being a nonprofit institution of learning is the creation of some public good. Do institutions accepting these federal benefits have the right to pick and choose which national issues to tackle? For example, the Forum (not Commission) on the Future of Higher Education, is a registered non-profit organization with an annual Aspen Institute gathering of self-described elites. That group in September refused to invite Charles Miller, chairman of the Spellings higher education commission, to join their discussions. The Forum members represent billions in federal funding and benefits.

Should the Ivy League, Williams, Stanford and other private non-profits accept public dollars and opt out of essential national debates? If these institutions wish to opt out, so be it. Then the proper organizational form is a private club. Accept no public funds. Pay property tax. Be left alone. County clubs assess for buildings and repairs without tax benefits.

Otherwise, create a demonstrable public good for the nation, not just the immediate campus. Here is a possible solution: Effective immediately, the federal government eliminates the tax benefits for the Ivy League, and all liberal arts colleges with endowments greater than $500 million. The feds will restore benefits based on measurable results when US low-income students have literacy second to none.

What Is A Nonprofit? And What Is the Value of a Nonprofit? What is the Appropriate Tax Status?

"Nonprofit" is a misunderstood term that its industry wants to keep that way. Nonprofit does not mean an entity always operating at a cash deficit, while struggling to do God's work. Nonprofit only means that the founders did not create the entity with the purpose of generating profits to distribute to owners and shareholders. Law prohibits nonprofits from distributing profits or surplus cash to shareholders. That's all. Many, including Williams and Yale, have had income exceeding expense for years. And this is due to hard work and good management. The undebated policy question is whether donations to cash-surplus generating entities should continue unchecked in face of vast social needs in other sectors.

Should all nonprofit institutions have the same tax status regarding endowment income and donations? In a system where tax status varies by institution, factors in the determination of that status might be total wealth and surplus relative to operating budget, the number of need-based scholarships, or demonstrations of public service. Harvard, Yale, Williams, and others, have endowments generating enough income to eliminate tuition. This is due to hard work, immense alumni generosity, and superb investment management. Yet tuition rises and we continue to provide tax subsidies and freeze Pell Grants.

Harvard, for example, has great wealth, no known plans to educate more students, and low Pell Grants. Let them keep their money but make future donations only 25% tax deductible instead of 100%, and, say, tax five percent of endowment income. Almost all higher education classrooms are dark on evenings and weekends. As a policy, why not eliminate, for five years, tax benefits for donations on buildings? And, to create a deeper private resource pool for the nation, why not give donations to endow need-based scholarships a deduction of 125%?

With limited resources, should tax benefits accrue in equal measure to every institution? Our current national policy is a resounding "Yes." Home ownership, with deductible mortgage interest, is the major example of how federal tax policy can direct national priorities.

Nonprofits, Higher Education, and Endowments vs. Foundations

Also buried in the fine print is the distinction among nonprofits between endowments and foundations. For colleges and universities, among others, the portfolio of money and assets is an endowment. No federal regulations govern endowment growth

and spending. Over the years, however, critics and Congress noted that many foundations, also tax exempt for donations and investment income, had growth in funds without increases in spending. Foundations are now subject to penalties if they fail to spend about five percent of their income per year. College and university endowments are not subject to this. No better illustration of the impact than from this September 25, 2006 press release announcing the 22.9% return on the Yale endowment, now $18 billion.

"Spending from the Endowment in the University's 2006-7 fiscal year is expected to total $676 million, or approximately 34% of the University's net revenues. The Endowment is Yale's single largest source of budgetary support. The share of the operating budget provided by the Endowment has more than doubled in the last ten years."

What's unsaid: The $676 million is only a paltry 3.8% of the total endowment. (Table 6) The $676 million is a staggering sum, exceeding the total endowment of most U.S. colleges and universities. Contributing 34% to the university budget is substantial. The situation collapses, though, under any basic return on investment calculations, for financial or for moral capital. Over the past ten years, the Yale endowment has grown at an average rate, Yale says, of 17.2%. Undergraduate enrollment over the same period is flat, varying around 5,300. Graduate enrollment has risen from 10,964 to 11,483, including 24 students displaced by Katrina. With essentially no increase in the number of students attending Yale, why is this money piling up while Pell Grants freeze?

Table 6: Return on Assets

Yale Endowment Example	
Return for FY 2006	22.9%
Growing to	$ 18,000,000,000
Endowment Spending FY 06/07	$ 676,000,000
Percent of Net Yale Revenues	34%
Percent of endowment spend	3.8%
Growth over past ten years	17.2%
Undergrad enrollment growth over ten years	0%

A Modest Proposal: For Discussion Only

What's a tax policy that provides incentives for a population educated for the 21st Century? A tax policy as powerful as the mortgage interest deduction for home ownership? Not free PhDs for all, but just the basics.

Defining education is possible. Our proposal: A tax policy that ensures that 90% of US residents, by the time they are 20 years old, can pass the AP exams in English Language and Composition and in Statistics. That will put everyone on a path of their own choosing. Revising tax policy for private university contribution is one means of realizing this goal.

Wick Sloane, a Boston-based educator and business consultant, is former chief financial officer of the University of Hawaii. Sloane welcomes comments and can be reached at wsloane@wcfl.com. His column, "The Devil's Workshop" appears on InsideHigherEd.com.

Jonathan Leirer is a research assistant with the Center for College Affordability and Productivity.

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