Testimony of

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U.S. Senate Committee on Health, Education, Labor and Pensions

Hearing: "Higher Education, Higher Cost and Higher Debt:
Paying for College in the Future"

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

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

Loans

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

Here's why:

- The federal guaranteed student loan program, FFEL, costs federal taxpayers billions of dollars annually, somewhat over $6 billion in 2007 according to OMB's estimates.[1] Moving net savings from ending FFEL guarantees to the Pell grant program, for example,

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

could put Pell funding back relatively soon near the levels it started with when first fully implemented in the 1970s.

- The guaranteed loan program was not originally intended to draw heavily from the federal treasury, but to fill a cash-flow gap for middle-income families not eligible for assistance under the federal government's loan and grant programs.[2] This is now 2007, but discussions surrounding the program sound like debates from more than three decades ago, when there was a lack of student access to capital. That time has long since passed.

- There are established alternatives. The Direct Loan program, by most credible accounts, is less costly as a vehicle to deliver Stafford and PLUS loans;[3] private loans for higher education, despite their troublesome rates, fees, and marketing practices, are now widely available and here to stay;[4] higher education tax benefits subsidize the higher education of the middle class.[5]

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

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

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

[5] At a December, 2006, Senate Finance Committee hearing, Susan Dynarski proposed elimination of the Pell grant program and putting the savings into refundable tax benefits. This is the scale of thinking appropriate to the need for major changes in the way we try to provide college access, but it would make more sense to wind down the FFEL program, for which there are alternatives, and put the savings into

- Excess student loan debt burden is a real problem; students often must take out loans because of a paucity of grants for those with financial need. A logical response would be to move loan subsidy expenditures to support of grant programs. As important as it is to keep *loan interest rates* low for students, it is also important to consider *loan principal*; that is, how to keep principal down or eliminate it entirely for many students through better grant funding.

- The student loan industry that has grown up around the FFEL program has become the tail that wags the dog. Recent HEA reauthorizations have focused on loan industry subsidies to the neglect of the needs of students and families; Big Education now rivals Big Oil and Big Pharm in political contributions, with commensurate effects on the legislative process.[6]

- The loan industry's consulting services have abetted the shift of college and university resources away from the financially needy, with the unsurprising result of higher loan burdens among low and middle income students and families. These industry-provided "enrollment management" services customarily countervail the mission of federal programs to assist the financially needy populations.[7]

Pell grants. Ironically, Congress established the guaranteed loan program in part as an alternative to tax benefit programs; having failed in that role, FFEL should be terminated, not Pell.

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

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

- There is a great deal of waste, abuse, and mismanagement[8] in the FFEL program, and perhaps outright corruption. The 9.5 percent guaranteed return scandal alone (in which several secondary markets in 2002-04 increased the volume of student loans paying a 9.5 percent guaranteed return, despite Congress's action in 1993 to phase out such loans) has cost federal taxpayers untold sums, perhaps billions of dollars. In 2003, I wrote an internal memorandum to the Department of Education's chain of command identifying how the abuse of the 9.5 guarantee was being perpetrated. Had the Department acted on my analysis and recommendations at that time (or on those of GAO, a year later), billions of dollars of growth in these loans and subsequent payments of hundreds of millions to loan holders could have been avoided.[9] As matters now stand, the Secretary of Education has determined that this was an illegal scheme, but one secondary market, Nelnet, has been forgiven $322 million and an unknown number of others are also being forgiven, before they have even been audited. Inasmuch as this is now undergoing Department of Justice review, I recommend that the Committee ask DOJ to delay any decisions until Congress has an oversight opportunity to review forgiveness of these illegal payments.

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

<u>*Loan Reform 1*</u>*:* Gradually reduce the federal guarantee on student loans until it is phased out. Congress should not beggar the Pell grant program for the sake of keeping an anachronistic guaranteed loan program afloat, the need for which existed thirty years ago but now is hardly compelling at a time when the student loan industry is several thousand lenders strong and is

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

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

quickly restructuring around private loan programs that already receive significant state and federal subsidies.[10]

Loan Reform 2: Use competitive bidding or auctions to set lender subsidies, rather than paying lenders a special allowance set by a lobbying process in Congress. One of the reasons the Direct Loan program is less costly than the FFEL program is *not* that it is run by the government, but that it is run by private industry through competitive bidding. Ironically, it is the government's hand in setting subsidies that makes the FFEL program an inefficient program compared to the one that is contracted out competitively to private industry. (Milton Friedman advocated the Direct Loan program with income-contingent repayment; perhaps such loans should be called "Friedman Loans.") GAO has already done an extensive study of competitive bidding and auction mechanisms appropriate to the FFEL program.[11] For example, one of the market mechanisms identified in the GAO report was a competitive bid sale of contractor-originated student loans, with or without a guarantee. Since that report, loan holders such as the Illinois Student Assistance Commission have undertaken loan sales through competitive bidding, to the benefit of students. On the other hand, establishment of some market mechanisms could be complicated to enact, and are less desirable than simply phasing out FFEL.

Loan Reform 3: Reform the student loan guaranty agencies by building on the lessons of the Voluntary Flexible Agreement provisions of HEA 98. Previously, guaranty agencies actually

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

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

had financial incentives to let borrowers go into default and then collect, rather than keeping the borrowers in repayment. The VFA provisions enabled the Department of Education to work with guaranty agencies to implement alterative payment systems so as to reverse these perverse incentives. Essential to this reform effort must be cost neutrality, if not cost savings, with the GAO report of 2002 on VFAs as a starting point.[12]

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

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

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

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

President Bush's budget directs FFEL savings to increase need-based grants, consistent with the recommendations of this testimony.

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

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

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

Grants

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

Part of the problem with federal grants (and I emphasize that it is only part of the problem) is that federal grant funding has not kept up with the cost of college. The federal Pell grant maximum in 1976 was $5064, expressed in constant dollars, compared to the current maximum

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

of $4050. To have the same purchasing power today as thirty years ago at a typical 4-year public institution, the maximum now would have to be raised to approximately $6400.[14]

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

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

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

Process

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

Here's why:

- Average students and families have a hard time filling out the FAFSA (Free Application for Federal Student Aid). Even CPAs have to turn to specialists to fill out these forms.

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

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

Many families are turning to consultants and paying high fees just to complete the applications.[16]

- The information families struggle to put into the forms is often irrelevant to the type and amounts of aid students eventually receive, after they go through what is known as the aid packaging process. Many institutions will give students the package they want them to have, regardless of federal need analysis or funding, because existing federal rules do not have the teeth to ensure that the federal funds are used for their intended purposes.[17]

- If students and families knew how their aid packages were put together, they would march on Washington. The reason they don't march is that the information is not available to them. How institutions package aid is often secretive, proprietary information.

- The prevailing packaging practice of the past few years among both public and private institutions has been to award more grant aid to better-prepared students at the expense of financially needy students, resulting in higher debt burdens for lower income families. These practices include those known as "enrollment management" and "financial aid leveraging."[18]

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

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

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

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

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

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

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

Process Reform 1: Require that if any federal aid is included in an aid package, the packaging process may not be considered confidential or proprietary, including preferred lender and private loan arrangements, enrollment management and financial aid leveraging techniques, and distributions of borrower benefits. Aid packaging and institutional arrangements with lenders should be, except as necessary to protect individual students' privacy, subject to the Freedom of Information Act and the Student Right to Know Act. Exposure to sunshine will change many

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

practices for the better without further regulation, and illuminate practices that need regulation.[20] The bipartisan, bicameral Student Loan Sunshine Act is a good place to start. It may also be time to require that students who have remaining federal loan eligibility be provided an informed consent process before a private loan is included in their aid package.

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

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

Process Reform 4: Place on probation (for participation in federal HEA Title IV programs) institutions that use enrollment management techniques to decrease low-income/first generation shares of enrollment.[22] Alternatively, if other reforms are not adopted, bypass some or all institutions in the awarding of federal aid.[23]

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[20] "Cherry-picking" students for borrower benefits, for example.
[21] "Fattening up financial aid," *The Boston Globe*, December 30, 2006; Institute for Higher Education Policy, "Expanding Access and Opportunity: Impact of the Gates Millennium Scholars Program," June, 2006.
[22] Suggestion comes from Tom Mortenson, "Five Questions for Enrollment Management," *Postsecondary Education Opportunity*, December 4, 2005. http://postsecondaryopportunity.blogspot.com/2005_12_01_postsecondaryopportunity_archive.html
[23] Suggestion comes from Richard Vedder, "The Administration's Pell Grant Initiative," February 1, 2007. http://collegeaffordability.blogspot.com/2007/02/administrations-pell-grant-initiative.html

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

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

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

Federal Research

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

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

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

Here's why reforms are needed:

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

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

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

[27] GAO found no student aid research works produced or contracted out by the Department that met standards for scientific rigor. See "Student Aid and Tax Benefits: Better Research and Guidance Will Facilitate Comparison of Effectiveness and Student Use," GAO-02-751, September, 2002, pp. 41, 46, 47. Several NCES studies have been criticized by academic researchers for reaching causal conclusions without using causal methodologies.

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

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

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

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

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

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

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

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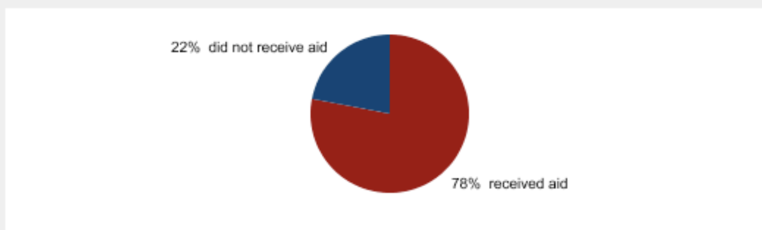
COOL: College Opportunities Online Locator

http://nces.ed.gov/ipeds/cool/screen.aspx?screenId=30

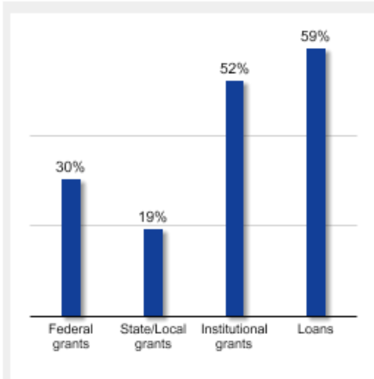
FINANCIAL AID

Undergraduate students: 2004-05

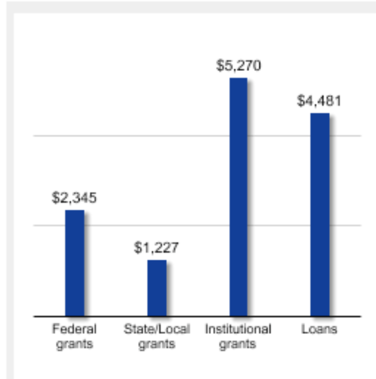
Percentage of students receiving any financial aid



Percentage of students receiving aid



Average amount of aid received



- Data apply to first-time degree- or certificate-seeking students.

For more information on Student Financial Assistance Programs or to apply for financial aid via the web, visit Federal Student Aid.

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Sept. 25

The Elephant in the Student Aid Office

By Donald E. Heller

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

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

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

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

The letter supports the commission's recommendation to increase the value of the average Pell award from 48 percent of the average in-state tuition at a public 4-year institution to 70 percent within five years. This is a noble goal, and having the support of the six lobbying groups is critical in helping to persuade Congress and the Bush administration to support it also. ACE's own calculations demonstrate that such an effort could require almost doubling the current $13 billion budget of the Pell grant program.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

-----Original Message-----
From: Whitehurst, Grover
Sent: Wednesday, November 26, 2003 2:24 PM
To: Oberg, Jon
Subject: RE: Two Items of Concern

Jon,

I will forward your letters to appropriate people.

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

November 21, 2003

To: Department of Education
Through: IES Chain of Command

Subject: Eliminating Waste in Department of Education Student Loan Programs

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

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

I expected to find increases in the amounts of the payments, given that students are paying historically low interest rates for Stafford loans and therefore ED must pay high spreads (as much as 6.68%) in order to provide the loan holders a 9.5% return. However, I expected to find declines in the base amount of the outstanding loans, inasmuch as Congress repealed the authority for the program in 1993. What I found instead was an increase in the amounts outstanding, some of it rapid in the past two years, with little legal authority for the increase beyond a trade association's interpretation of a 1996 ED letter. I found no effort at ED or Treasury to evaluate the program under the requirements of the Government Performance and Reporting Act (GPRA), and I have little reason to think the payments are systematically distributed in any way that would result in expanding postsecondary opportunity. The payments go to both for-profit and not-for-profit entities.

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

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

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

> A portion of our FFELP loan portfolio, with an outstanding balance of $925.2 million as of June 30, 2003, is comprised of loans, which were previously financed with tax-exempt

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

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

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

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

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

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

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

Jon H. Oberg
IES/NCER