STATEMENT OF

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Mr. Chairman, I am pleased to be here today to discuss with you reductions in the budget for 1981 and 1982. In my remarks I will examine the Administration's proposal and other options for reducing federal spending for student aid.

Growth of Student Aid in the 1970s

The 1970s witnessed rapid growth in federal student assistance. In 1972, the Basic Educational Opportunity Grants program (now known as the Pell Grant program) was established, which along with other related programs focused on reducing financial barriers to college attendence for low-income students. The Guaranteed Student Loan (GSL) program, established in 1966, addressed a somewhat different goal--to help reduce the financial burden for less needy students and to supplement the grant aid provided to the most needy students. But until recently even the GSL program restricted eligibility for the highly subsidized loans to students from families with incomes below a specified level.

In the late 1970s the federal focus began to shift. The Middle-Income Student Assistance Act of 1978 (MISAA), and the Higher Education Amendments of 1980, significantly expanded the scope of federal student assistance. MISAA extended eligibility for the highly subsidized GSLs to all students enrolled at least half time, expanded eligibility for Pell Grants, and increased the authorized funding ceilings for most existing student aid programs. The amendments of 1980 increased the maximum amounts that

students can receive in each of the grant programs, eliminated equity in the family home as a consideration in determining financial need, and created a loan program for parents.

Federal funding also increased from $0.6 billion in 1970 to $4.5 billion in 1980, an increase of more than 250 percent even after adjusting for inflation. Nearly all of this increase, however, occurred early in the decade. Although eligibility for student assistance has twice been expanded since 1976, funding for these programs, in real terms, has not increased.

Expanding eligibility without also increasing funding in real terms has led to a reduced federal commitment to assist the most needy students, while it has increased the assistance given to less needy students. This result has been particularly evident during the past year. While $130 million was rescinded in funding for the needs-based BEOG program in fiscal year 1980, the untargeted GSL program received nearly $650 million in supplemental funds. Likewise, the fiscal year 1981 continuing resolution cut funding for the needs-based National Direct Student Loan (NDSL) program by $100 million, a 35 percent reduction from fiscal year 1980, while it increased funding for the GSL program by $900 million, or 56 percent.

Without some change in the current programs, any future funding constraints would lead to a continued shift away from helping the most

needy students. Funding for the needs-based grant, work-study, and loan programs would have to be cut to allow for growth in the untargeted GSL program, which as an entitlement program must always receive the first dollars appropriated for student assistance.

Options for 1981

Before establishing federal policy for 1982 and beyond, the Congress must resolve some funding issues for 1981. The Pell Grant program needs a supplemental appropriation for fiscal year 1981 of $1.3 billion to provide the level of services assumed in the continuing resolution and to pay for 1980 cost overruns in the program. GSL costs will amount to $1.1 billion more than was included in the continuing resolution.

To gain control of the rising student assistance costs, the Administration has proposed changes to both the Pell Grant program and the GSL program in fiscal year 1981. In the Pell Grant program, the Administration proposes a combination of changes that would (1) keep the maximum grant at $1,750, (2) rescind the previously approved inflation adjustment in the family living allowance, (3) require a $750 self-help contribution from every student, and (4) rescind the liberalized cost-of-education definitions included in the Higher Education Amendments of 1980. We estimate that these changes would reduce program costs to $2.4 billion (compared with the Administration's estimate of $2.6 billion), which would lower the needed supplemental to $0.7 billion. All but the most needy students would receive less under this approach. Approximately 100,000

fewer students would receive grants, and the average award would be reduced nearly $200 (a 17 percent decrease).

The Congress has other options for reducing 1981 Pell Grant costs. It could, for example, implement the two-staged reduction procedure contained in the current law. The first stage would reduce awards using a schedule that protects the most needy students from any reduction and gradually increases the level of reduction for less needy students. Based on an $1,800 maximum grant in 1981, this scheduled reduction would reduce program costs by $0.2 billion, lowering the needed supplemental to $1.1 billion. If a greater reduction was required, it could be achieved through the second stage of the scheduled reduction, which would reduce all awards proportionately. Reducing expenditures to the level of funds in the continuing resolution would require reducing the effective maximum grant to approximately $1,100.

Another way to cut program costs would be to reduce each award by an equal dollar amount, the strategy adopted in fiscal year 1980. If the current funding for 1981 is not increased, each award would have to be reduced by approximately $550. Approximately 700,000 fewer students would receive grants.

To control GSL costs, the Administration proposes eliminating the in-school interest subsidy on student loans, limiting borrowing to assessed financial need, and raising the interest rate on parent loans to offset all

federal costs. These changes would go into effect in July 1981, which would significantly reduce GSL loan volume in the last quarter of fiscal year 1981; it would, however, achieve no fiscal year 1981 outlay savings because interest payments for the final quarter are not paid until the first quarter of the subsequent year. We estimate that limiting eligibility to assessed need would reduce the eligible pool of borrowers by roughly 50 percent, with the reduction in volume dependent upon the severity of the needs test.

Restricting eligibility would not only reduce the potential demand for loans; it could also affect the supply of capital available through private lenders. Requiring a needs assessment would increase the program's complexity and reduce lenders' yield per dollar loaned because the average loan amount would go down but administrative costs for each loan would not. These changes would make the program less attractive to lenders and, as a result, some students (particularly the most needy students, who are generally less preferred borrowers) could have difficulty obtaining loans.

Implementing the changes prior to the last quarter would significantly increase future cost savings. More than 50 percent of annual loan volume occurs in this quarter, and so any change that reduces this volume will essentially capture half the future savings associated with a full year of program activity. On the other hand, it would not be easy to complete new legislation within the next four months.

Options for 1982

To control Pell Grant costs in fiscal year 1982, the Administration proposes increasing the assessment rate on discretionary income and eliminating the deduction of state and local income taxes from income in determining the family contribution. We estimate these changes would result in program costs of $2.4 billion (compared with the Administration's estimate of $2.5 billion). Approximately 575,000 fewer students would receive grants than in this academic year (1980-1981).

Another option would be to maintain the $1,800 maximum grant level (instead of the $2,100 limit allowed in the law), but adopt all other provisions of the 1980 amendments. This plan would require funding of $2.9 billion.

Again, there are many alternative ways in which Pell Grant program costs could be reduced through action by the appropriations or authorizing committees. We would be happy to analyze any specific proposals you consider.

With respect to GSLs, the Administration could continue in fiscal year 1982 the reductions proposed for initial implementation in late 1981. Because fiscal year 1981 loan volume would have been significantly reduced, this proposal would achieve sizable budget savings in fiscal year 1982. We estimate budget authority would decline by $0.9 billion and outlays by $0.2 in 1982.

The Congress could reduce the growth in GSL program costs in a number of other ways that would not seriously jeopardize the availability of loan capital. One option would be to require that interest be paid on the loans while the students are in school, which would reduce GSL costs by $0.4 billion in fiscal year 1982. Currently the federal government pays the interest during that time; eliminating this subsidy would cut the long-term federal subsidy for each dollar loaned in half. Furthermore, although eliminating the in-school interest subsidy would not reduce GSL eligibility, it would tend to reduce the amount borrowed because the loans would be a less attractive source of funds to potential borrowers. We estimate that demand would decline by roughly 25 percent. Requiring students to pay interest while they are in school could, however, impose a significant burden on them. Many students, in fact, would probably increase the amount they borrowed to pay the interest costs.

An alternative would be to defer payment of accrued interest until the borrowers have left school. If the federal government were to reimburse lenders for the deferred interest, the initial savings would be modest; first-year savings are estimated to be $124 million, a decrease of about 5 percent. As the loans entered repayment, however, the deferred interest payments would be recaptured, and cost savings would increase. By 1986, costs would be reduced by more than $2 billion, a decrease of 35 percent from projections of current policy. Although this option would minimally increase the administrative complexity of the program, it should be possible to structure the changes in a way that would be acceptable to

lenders so that they would not withdraw from the program. This would ensure that students from families of all income levels would retain access to the funds necessary for their education.

Another way to reduce GSL program costs would be to cut the subsidy to lenders by reducing the rate used to determine their special allowance payment. Currently private lenders (banks and thrift institutions) receive a special allowance payment from the federal government that assures them a yield equivalent to the 91-day Treasury bill rate plus 3.5 percentage points. During the past quarter, the federal payment was 11 percent on all outstanding loan capital; this, combined with interest payments on the loans, ensured lenders a yield of 18 percent.

Reducing the special allowance payment would reduce federal costs for each dollar loaned, with the amount of savings depending on how much the special allowance was reduced. Initially federal savings would be relatively modest because special allowance payments for new loan volume represent only a small portion of total program costs (approximately 7 percent in fiscal year 1981), but these savings would increase in future years.

Reducing the yield to lenders, however, might cause them to reduce their participation in the program. Any significant reduction in the special allowance that was not offset in some other way--as by allowing lenders to charge higher interest rates to borrowers--would make the GSL

program unprofitable for lenders. A relatively small reduction in the total yield might still allow them some profit on student loans, but even marginal reductions would decrease the attractiveness of GSLs relative to other investment opportunities available to lenders.

Conclusion

The Congress faces a difficult set of decisions. Unless current policies are changed, any reduction in federal funding for student assistance will reduce aid to the most needy students while leaving unchecked the rapid growth in untargeted aid to less needy students through the Guaranteed Student Loan program. In examining alternative policies, it will be important to weigh both the cost savings and the likely effects, intended and unintended, on recipients, borrowers, and lenders.