STATEMENT OF

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before the

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Mr. Chairman, the federal government plays a large role in helping finance the education of postsecondary students. Student assistance programs--expected to cost more than $8 billion in fiscal year 1984--have grown sharply over most of the past 15 years, and their focus has changed. The Subcommittee now has before it two major proposals that would further alter student aid programs--the Administration's fiscal year 1985 proposal and the Chairman's reauthorization proposal (H.R. 5240).

My remarks today will cover three topics:

- The goals of student assistance efforts and issues to consider in designing aid;
- Current federal programs; and
- The two proposals before the Subcommittee, as well as other options available to the Congress.

POLICY GOALS AND ISSUES

Goals

Several goals motivate the federal government to help defray the costs of higher education. One objective is to increase the overall level of educational attainment. While many gains from higher education accrue to the students themselves, other benefits are realized by society at large through increased productivity resulting from a better-trained workforce, and through a richer cultural life resulting from a better-educated population. Another major goal of student aid is to promote greater equality of opportunity by improving access to postsecondary education for lower-income persons who might not otherwise be able to continue their schooling. A related objective is to broaden the choice of institutions for all students by allowing them to attend more costly schools than they otherwise could. Finally, student assistance may serve as a means to support a greater diversity of institutions--promoting, for example, specialized or especially expensive schools that might not otherwise be able to attract sufficient numbers of students at the costs that would have to be charged.

Issues

Three main issues face the Congress in designing and funding student assistance programs to address these goals: who should pay, who should benefit, and who should allocate aid.

The first issue is what share of educational costs students and their families should bear, and what share government should pay. The answer to this question depends on views concerning several factors--the degree of societal gains resulting from higher education, the value of education compared to competing demands for scarce federal resources, and the effectiveness of these programs in meeting their objectives. A related question is what portion of costs borne by government should be paid at the federal level and what portion should be paid by states and their subdivisions.

A second issue is which students the federal government should help--that is, how to allocate whatever assistance is available. A major question concerns the extent to which federal aid should be focused on the lowest-income students, and the extent to which programs should also consider educational costs. For any fixed amount of aid, focusing on the lowest-income students could enable more of them to continue their educations but might limit their choice of institutions to those with lower costs. Taking greater account of educational costs could expand students' choices by giving more aid to those attending high-cost schools but would necessarily divert some aid from students attending less costly institutions. A related question concerns barriers to attending high-cost schools--particularly for higher-income students--that arise not because they and their families cannot afford their educational costs, but because they cannot finance them in private lending markets. To the extent that this is the case, the federal government could meet this need by encouraging an active private market in educational loans.

A third broad issue is the extent to which federal aid programs should treat similar students uniformly. The greater the proportion of aid that is distributed among students using uniform federal rules, the more similar will be the treatment of similar students--potentially targeting aid more narrowly on the lowest-income students. Colleges and universities would then have less discretion, however, to deal with special circumstances not reflected in federal aid formulas.

CURRENT FEDERAL PROGRAMS AND RECENT TRENDS

Current Programs

The federal government currently helps finance the education of about 40 percent of all postsecondary students through grants, work-study aid, and direct and guaranteed loans. The largest grant program--Pell Grants--provides aid directly for low-income students through a federal formula that is somewhat sensitive to school costs. Two other grants--Supplemental Educational Opportunity Grants (SEOGs) and State Student Incentive Grants (SSIGs)--distribute funds to schools and states, respectively, which then allocate the money among students. Overall, these two programs are less heavily targeted on the lowest-income students than are Pell Grants.[1] The College Work-Study program offers a different type of aid, paying 80 percent of students' wages in jobs on campus and in nonprofit institutions, thereby providing jobs that perhaps might not otherwise exist. Although this aid is income-tested, schools have fairly broad discretion in allocating the assistance, and they do not necessarily target it heavily on the lowest-income students.

1. Other grant programs--veterans' education and Social Security student benefits--support aid for specific groups of students. These programs are outside the jurisdiction of this Subcommittee and are not considered at length in the statement.

Through the Guaranteed Student Loan (GSL) program, the federal government guarantees the principal and pays a share of the interest on privately financed loans for all students with family incomes below $30,000 who choose to borrow, and for higher-income students who satisfy a needs analysis that considers income in comparison to school costs and other available aid. Through the National Direct Student Loan (NDSL) program, the federal government provides funds that schools use to make reduced-interest loans. The Auxiliary Loans to Assist Students (ALAS) program provides loans with substantially smaller subsidies to independent students and parents of dependent students who either are ineligible for GSLs or have borrowed the maximum amounts. These programs allow some students to qualify for loans they might not otherwise be able to get and reduce the long-run interest costs of all borrowers.[2] The loan programs serve, on average, higher-income students and provide a greater proportion of assistance to students at more expensive colleges and universities than do the grant programs.

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2. Because loans must eventually be repaid, they are less valuable to students--and less costly to the government--than outright grants of the same size. In the case of reduced-interest loans for students who would otherwise have borrowed at the full-market rate, the value of the subsidy is equal to the difference between the payments that would have been made on a market-rate loan and the payments made at the reduced rate of interest. Because the interest subsidy is realized over a period of many years, it must be expressed in present-value terms--that is, the value today of benefits realized in the future--to be comparable with the direct subsidy figures under grant (Continued)

Recent Trends

Postsecondary student assistance programs grew substantially during the 1970s and, despite recent reductions, remain at levels well above those at the beginning of the last decade (see Table 1). Between 1970 and 1984, outlays for all forms of aid increased more than fourfold, but the emphasis has shifted over time. The share of aid provided through loans rather than grants has increased, the proportion distributed under uniform federal rules has grown, and the percent provided to students at more expensive schools has risen.

The extent to which this increase in federal aid has improved the access of students to postsecondary education or expanded their choice of schools is difficult to assess. Although there is some evidence to suggest that increased aid has raised the probability that low-income persons will further their educations, these students are still much less likely than

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2. (Continued)

programs in which all the benefits are realized immediately. When federal loan costs are also spread over many years, those costs also must be expressed in present-value terms to be comparable with grant outlays. For GSLs expected to be provided in 1984, for example, the present-value of the subsidy is estimated to range between $450 and $550 per $1,000 loan, depending on the assumptions made about the market rate available to students in the absence of federal aid. The federal cost in present-value terms of GSLs is estimated to be about $400 per $1,000 loan--less than the subsidy because the government can borrow at a lower rate of interest than can students. The federal subsidy for the ALAS program is lower, and for the NDSL program is higher, than for the GSL program.

TABLE 1. FEDERAL POSTSECONDARY STUDENT AID (By fiscal year, in billions of dollars)

	1970	1978	1981	1984 (estimate)
		Outlays		
Grants				
Pell Grants	--	1.6	2.5	2.5
SEOGs	0.2	0.3	0.4	0.3
SSIGs	--	a/	0.1	0.1
Veterans education benefits	0.8	2.8	1.9	1.2
Social Security student benefits	0.4	1.4	2.0	0.4
Subtotal	1.4	6.1	6.8	4.5
Work-Study Aid	0.2	0.4	0.6	0.6
Loans				
GSLs b/	0.1	0.5	2.5	3.0
NDSLs	0.2	0.1	0.3	0.2
Subtotal	0.3	0.6	2.8	3.2
Total	1.9	7.1	10.2	8.3
		Loan Volume		
GSLs b/	0.8	2.0	7.8	7.1
NDSLs c/	0.3	0.4	0.7	0.7
Total	1.1	2.4	8.5	7.8

NOTE: Details may not add to totals due to rounding.

a. Less than $50 million.
b. Includes the ALAS program in fiscal years 1981 and 1984.
c. Loan volume from the new federal capital contribution and repayments of previous federal contributions. Does not include institutional matching funds.

higher-income ones to continue their schooling. To the extent that federal student aid has enabled institutions to raise tuitions--using the proceeds for program enrichment or salary increases, for example--it may have improved the quality of schools or shifted the benefits to groups other than students receiving federal financial aid, while increasing educational costs. Finally, the growth of GSL volume, in particular, has probably enabled some private institutions to attract students in a period of slow growth in the college-age population and thereby assisted the maintenance of a broader variety of educational alternatives.

OPTIONS

The two major student aid proposals now before the Congress would address program design and funding issues differently. The Administration's proposal would reduce the amount of educational costs paid by the federal government, while focusing available aid on students at more expensive schools and attempting to protect the lowest-income students from cutbacks. H.R. 5240, on the other hand, would increase the share of all educational costs borne by the federal government, providing more aid to many students, not just the lowest-income ones. Both proposals would treat similar students somewhat more uniformly than do current programs by increasing the portion of federal aid allocated by federal rules.

The Administration's Proposal

The Administration's 1985 proposal for postsecondary student aid would reduce the overall share of educational costs subsidized by the federal government by reducing both grants and loan volume while increasing work-study aid. In total, the Administration's funding request would reduce grants by $700 million and loan volume by $1.1 billion and would increase work-study aid by almost $300 million, compared to continuing current policies (see Table 2).

With respect to Pell Grants, the Administration proposes to increase the maximum award from $1,900 to $3,000 and make amounts awarded more sensitive to school costs. While the Administration has requested $2.8 billion to fund this proposal in 1985, the Congressional Budget Office (CBO) estimates that providing awards to all eligible students who would apply would cost 30 percent more, or $3.7 billion. Under current law, if projected Pell Grant costs exceed the appropriation, students' awards must be reduced unless additional funds are appropriated. Because we do not know how the Administration or the Congress would deal with a funding shortfall, it is difficult to determine the overall effects of this proposal on different types of students. If sufficient funds were appropriated so that full grants could be provided to all eligible applicants, students at high-cost schools would generally receive larger awards than now; students at low- and medium-cost

TABLE 2. FEDERAL POSTSECONDARY STUDENT AID IN FISCAL YEAR 1985 UNDER ADMINISTRATION AND H.R. 5240 PROPOSALS (In billions of dollars)

	Current Baseline Estimate	Administration's Proposal[a/] With Requested Pell Funding Level	Administration's Proposal[a/] With CBO Estimate of Cost to Fund Pell Grants	Estimate of H.R. 5240[b/]
		Budget Authority		
Grants				
Pell Grants	3.0	2.8	3.7	6.1
SEOGs	0.4	--	--	0.6[c/]
SSIGs	0.1	--	--	--
Subtotal	3.5	2.8	3.7	6.7
Work-Study Aid	0.6	0.9	0.9	0.6
Loans				
GSLs[d/]	3.0	2.8	2.8	3.2
NDSLs	0.2	--	--	0.2[c/]
Subtotal	3.2	2.8	2.8	3.4
Total	7.3	6.5	7.4	10.7
		Loan Volume		
GSLs[d/]	7.5	6.6	6.6	7.0
NDSLs[e/]	0.7	0.5	0.5	0.7
Total	8.2	7.1	7.1	7.7

SOURCE: CBO estimates.

a. Includes CBO estimate for GSL program.
b. H.R. 5240 would not be fully implemented until fiscal year 1987. Effects are shown as if it were fully effective in 1985 in order to make it comparable to the Administration's proposal.
c. H.R. 5240 includes one campus-based program for grants and loans to replace the SEOG, SSIG, and NDSL programs. These estimates assume the same proportions spent on grants and loans as in the programs being replaced.
d. Includes the ALAS program.
e. Loan volume from the new federal capital contribution and repayments of previous federal contributions. Does not include institutional matching funds.

schools would get larger awards only if they were in the lowest-income group.

For the GSL program, the Administration's proposal would extend needs analysis to all borrowers and would require that all state agencies, which guarantee loans that are reinsured by the federal government, bear some risk in the case of defaults. The universal needs analysis would eliminate or reduce loans for many students--especially for persons financially independent of their parents, who would be expected to devote a large share of their discretionary income towards their own education, and for students attending lower-cost schools. Sharing default risks with the states would lower eventual federal costs. In all, we estimate that the Administration's GSL proposal would require $2.8 billion in budget authority in 1985--about 8 percent less than continuing current policies.

Finally, the Administration proposes to eliminate SEOGs and SSIGs and additional capital contributions for NDSLs, while increasing funding for work-study aid by almost $300 million. Eliminating the SEOG and SSIG programs and sharply curtailing NDSL lending would reduce aid for students now benefiting from these programs, but some of these reductions could be made up through increased funding for the work-study program and through Pell Grants if the Administration's proposal were funded at its full costs. In any event, the new system would treat students more uniformly, while leaving schools to allocate only work-study funds and NDSL repayments.

H.R. 5240

In contrast to the Administration's proposal, H.R. 5240 would sharply increase the share of school costs subsidized through federal aid by greatly increasing grants, while keeping work-study funding level and slightly reducing loan volume.[3] It would increase funding for grants by $3.2 billion, keep work-study aid roughly the same, and reduce loan volume by $500 million in 1985, compared to continuing current policies (see Table 2). Moreover, because H.R. 5240 would change the Pell Grant program from an appropriated program to an entitlement, future costs would be more difficult to control.

H.R. 5240 would increase the maximum Pell Grant award to $3,000 and would raise the maximum portion of school costs that could be covered by grants. CBO estimates that this proposal would cost about $6.1 billion in fiscal year 1985--twice the amount necessary to continue current Pell Grant policies. Under the entitlement approach, about 1 million more

3. This analysis is based on CBO's understanding of H.R. 5240 to date as specified by Subcommittee staff. Although H.R. 5240 would not be fully implemented until fiscal year 1987, the effects are shown in fiscal year 1985 in order to compare it to the Administration's proposal.

students would receive Pell Grants than do now, and most current recipients would get significantly larger awards. Students at low-cost schools would benefit more than under either the Administration's proposal or current policies because a higher proportion of school costs would be met by Pell Grants. In addition, graduate students, who are now ineligible, could receive Pell Grants during the first year of graduate study.

Like the Administration's proposal, H.R. 5240 would require a needs analysis for all GSL borrowers; however, H.R. 5240 would also raise the annual loan limits from $2,500 to $3,000 for undergraduates and from $5,000 to $7,000 for graduate students. In addition, the Chairman's proposal would eliminate a 5 percent loan origination fee that was instituted in 1981. The universal needs analysis would make some students ineligible or reduce the amounts they could borrow; this would be especially true for those at low-cost schools and for some who are independent of their parents. On the other hand, the higher loan limits would increase aid available to other students, particularly those attending more expensive institutions. Eliminating the loan origination fee would reduce all borrowers' net costs.

In addition, H.R. 5240 would reduce the interest rate paid to GSL lenders by one-half percentage point while students are in school. This would lower federal spending by about $60 million a year without affecting students' costs. Although this change could affect loan availability, it seems unlikely. In total, H.R. 5240 would increase federal funding requirements for GSLs to $3.2 billion in 1985--about 6 percent above the current-policy level.

H.R. 5240 would fund campus-based grants and loans (replacing SEOGs, SSIGs, and NDSLs) through one slightly expanded program, while continuing funding for work-study aid. This would give school officials more aid to allocate at their discretion than now, although a higher proportion of aid would be determined by federal rules because the Pell Grant program would grow even more quickly than the campus-based programs.

Other Alternatives

Other options are, of course, available to the Congress. First, marginal changes could be made in existing programs, for example, by restructuring parental contribution schedules or by raising the share of interest paid by students under the GSL program.

Alternatively, the Congress could fundamentally restructure student assistance. At present, each aid program tries to serve several of the higher education goals described above, possibly reducing the system's overall effectiveness. Instead of continuing the current system, the Congress could consider an explicit three-tier approach. All grant aid could be targeted to the lowest-income students, thus providing larger awards for them;

subsidized loans could be provided for both low-income students and somewhat higher-income students; and unsubsidized--or substantially less subsidized--loans could be made available to all students who chose to use them. This could reduce the burden borne by low-income students, while making it easier for all students to attend higher-cost schools, although many of them would have substantial debts when they graduated. Under such a scheme, all aid would be allocated through uniform federal rules, and higher education institutions would have much less discretion in tailoring financial aid packages.