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EDUCATION AND TRAINING TAX PROVISIONS OF THE ADMINISTRATION'S FISCAL YEAR 1998 BUDGET PROPOSAL

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

MARCH 5, 1997

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EDUCATION AND TRAINING TAX PROVISIONS OF THE ADMINISTRATION'S FISCAL YEAR 1998 BUDGET PROPOSAL

WEDNESDAY, MARCH 5, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room 1100 Longworth House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
February 20, 1997
No. FC–3

Archer Announces Hearing on the Education and Training Tax Provisions of the Administration's Fiscal Year 1998 Budget Proposal

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on the Administration's tax-related education and training proposals, along with other proposals to promote postsecondary education. The hearing will take place on Wednesday, March 5, 1997, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

Oral testimony at this hearing will be heard from invited witnesses only. Witnesses will include Members of Congress, representatives of the Administration, and education and vocational training representatives. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND

The Clinton Administration's recently released budget for fiscal year 1998 contains several provisions regarding education and job training. Among these provisions are the Hope scholarship tuition tax credit, a tax deduction for secondary education tuition and for job training, tax incentives for the expansion of student loan forgiveness, an extension of the tax exclusion for employer-provided educational assistance, and a small business tax credit for employer-provided educational assistance.

In announcing the hearing, Chairman Archer stated: "I applaud President Clinton for his focus on how to make college and other education expenses more affordable for Americans. This hearing will help the Members of the Committee on Ways and Means determine the best and most efficient way for American families to cope with these ever-rising costs."

FOCUS OF THE HEARING

The hearing will examine the education and training tax provisions contained in the Administration's fiscal year 1998 budget proposal.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Wednesday, March 19, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested

public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS_MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–225–1904 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

—

Chairman ARCHER. The Committee will come to order. Today marks the first of several hearings on the revenue proposals in the President's fiscal year 1998 budget. This morning, we will be examining the educational tax incentives in the President's budget, as well as other proposals designed to make higher education more affordable for taxpayers and their families.

Last January, I wrote Secretary Rubin expressing my strong interest in exploring ways to use the Tax Code to put higher education more within the reach of American families. This interest takes root in a landscape that has changed considerably since I financed the college costs of my five children. And I must say that I am happy that they are all out of college today because at one time all five of them were in college the same year, and that would be a significant hurdle with today's costs.

Although the importance of higher education remains undiminished, tuition costs over the past 15 years have well out-

paced inflation. In fact—and I am amazed at this—but the fact is that they have increased at double the rate of medical inflation. This translates into mind-numbing costs at 4-year institutions, particularly for average families whose incomes are already burdened by Federal, State and local taxes.

We must also be sensitive to the educational needs of young adults whose families are unwilling or unable to provide them with assistance and who missed earlier opportunities to attend college.

This past week, we met with students representing the Minnesota Community College Student Association. We learned that the average profile of a community college student is a person aged 26, with one dependent. For these adults who are working so hard to get an education, the prospects of significant educational debt are not particularly attractive.

Of course, the goals of access and affordability of higher education are not new to the Republican Congress. The Balanced Budget Act of 1995, vetoed by the President, contained important educational incentives. Most notable were tax-free IRA withdrawals for postsecondary education and an above-the-line deduction of $2,500 for student loan interest.

Senator Paul Coverdell, Chairman of the Senate Task Force On Education, will testify before us shortly on the Senate Republican education package, the bill S. 1. The administration has proposed more than $35 billion of temporary tax education incentives over the next 4 years. According to the statutory language provided to us by the administration, the President's education provisions will terminate on December 31 in the year 2000.

Nonetheless, these initiatives represent the potential for a historic expansion by the Federal Government in the area of higher education. They also represent an increase in the role and the power of the IRS in enforcing the B-minus average provision contained in the President's tax credit proposal.

It is important, therefore, that we examine these proposals very closely to ensure that our shared objectives will be met. This means evaluating the details of the President's initiatives as they relate to administration and what impact they might have on tuition costs and educational quality.

Finally, any package of educational benefits needs to reflect the reality that pursuing a college education is not the only path to success. Less than 25 percent of our population between the ages of 25 and 35 have a bachelor's degree. Bill Gates of Microsoft chose a different path as did many individuals who have pursued careers as plumbers and electricians. Thus, we should not ignore the financial needs of those who forego "higher education" for other forms of vocational education and training.

[The opening statement follows:]

Opening Statement of Hon. Bill Archer, a Representative in Congress from the State of Texas

Today marks the first of several hearings on the revenue proposals of the President's FY 98 budget. This morning we will be examining the educational tax incentives in the President's FY 98 budget, as well as other proposals designed to make higher education more affordable for taxpayers and their families.

Last January, I wrote to Treasury Secretary Rubin expressing my strong interest in exploring ways to use the tax code to put higher education within the reach of more American families. This interest takes root in a landscape that has changed considerably since the time I financed the college costs of my five children.

Although the importance of higher education remains undiminished, tuition costs over the past 15 years have well outpaced inflation. In fact they have been increasing at double the rate of medical inflation. This translates into mind-numbing costs at four-year institutions, particularly for average families whose incomes are already burdened by federal, state and local taxes.

We must also be sensitive to the educational needs of young adults whose families were unwilling or unable to provide them with assistance, and who missed earlier opportunities to attend college. This past week, we met with students representing the Minnesota Community College Student Association.

We learned that the average profile of a community college student is a person aged 26 with one dependent. For these adults, who are working so hard to get an education, the prospects of significant educational debt are not particularly attractive.

Of course, the goals of access and affordability of higher education are not new to the Republican Congress. The Balanced Budget Act of 1995, which was vetoed by the President, contained important educational incentives. Most notable were tax-free IRA withdrawals for post-secondary education and an above-the-line deduction of $2,500 for student loan interest. Senator Paul Coverdell, Chairman of the Senate Task Force on Education, will testify before us shortly on the Senate Republican education package, the bill S.1.

The Administration has proposed more than $35 billion of temporary education tax incentives over the next four years. According to the statutory language provided to us by the Administration, the President's education provisions will terminate on December 31, 2000.

Nonetheless, these initiatives represent the potential for an historic expansion by the federal government in the area of higher education. They also represent an increase in the role and the power of the IRS in enforcing the B average provision contained in the President's tax credit proposal. It is important, therefore, that we examine these proposals very closely to ensure that our shared objectives will be met. This means evaluating the details of the President's initiatives as they relate to administration and what impact they might have on tuition costs and educational quality.

Finally, any package of educational benefits needs to reflect the reality that pursuing a college education is not the only path to success. Less than 25 percent of our population between the ages of 25 and 35 have a bachelor's degree. Bill Gates chose a different path, as have many individuals who have pursued careers as plumbers and electricians. Thus, we should not ignore the financial needs of those who forego "higher education" for other forms of vocational education and training.

I look forward to hearing today from our invited witnesses.

—

Chairman ARCHER. So, I look forward to hearing today from our invited witnesses and I see that where I would normally yield to the Ranking Democrat, Mr. Rangel, for an opening statement, he is going to be our first witness.

So, would you like to testify both as a witness and make an opening statement, Mr. Rangel, or what is your preference?

Mr. RANGEL. Mr. Chairman, Mr. Stark will make our opening statement.

Mrs. JOHNSON of Connecticut [presiding]. I see now that we are going to recognize Mr. Stark to give the Democrats opening statement. We are going to reserve Mr. Rangel as our first witness.

Mr. Stark.

Mr. STARK. Thank you, Madam Chair.

Thank you for calling these hearings. I, in addition to our distinguished Ranking Member and other Members who may testify, I wanted to welcome Secretary Lubick to this hearing on education work incentives. I have known you, Mr. Secretary, for a long time and you know I am not much for holding back when I have concerns about legislative proposals.

And I do have reservations about the merits of the proposals before us today. My concern with the welfare-to-work proposal is that I know of no evidence that tax credits actually create any new jobs. We do have some history there. The new jobs tax credit in the late seventies, which the Chair and I were here for, was little used because it was too complicated.

Its successor, the targeted jobs tax credit, like a cat with nine lives, survived a brutal report by the Department of Labor in 1993 and with a change in name called the work opportunities tax credit and a change in certification process. But the critical issue in all versions of the job credit has been whether the credits created any new jobs? The answer has been, at best, inconclusive. Mr. Katz, the chief economist at the Labor Department in 1993 and 1994, after reviewing the literature on jobs credit, raised the issue that the targeted credits stigmatized workers.

Stand alone subsidies that are highly targeted on very specific socioeconomic groups appear to be somewhat less effective than more broadly targeted subsidies and may stigmatize the group, he wrote.

The 1993 Department of Labor study on the effectiveness of jobs credits showed that employers would have hired 95 percent of the participants regardless of the tax subsidy. The jobs turned out to be part-time, low-skilled, low-paying, high-turnover, and offered no career path. The pay of the participants was usually similar to the pay earned before and after participating in the program, and that participating employers who used the targeted jobs tax credit are often corporations which require a steady stream of workers to fill large numbers of high turn-over jobs.

So, I hope you will address in your testimony, Mr. Secretary, what research the administration can point to that targeted tax credits create any new jobs, not just an increase in jobs for the targeted groups at the expense of jobs for other workers.

This Committee needs to have a better understanding of how you can spend a half a billion dollars on one more program when the history indicates it will not create jobs and will not help improve a lot of workers.

Second, the Chairman discussed the education provisions in the budget and I am not very enamored with those either. The non-refundable tax credit, $1,500 a year for 2 years, and the deduction do not help the low-income students who are most in need of the Federal boost to ensure they become educated members of our society.

Neither you nor I, Mr. Secretary, can guarantee that increased spending through the Pell grants will survive the budget process. Likewise, I am troubled by the changes to the employer-provided education assistance provision. Why we should want to expand this benefit for the use of graduate level training baffles me. It is not enough to be college educated, have a good job and receive supplement to your pay for further studies, we want to add more and make it tax-free to boot.

We provide a tax incentive to a group of taxpayers who really need no further incentive or subsidy to upgrade their skills. I am taking up more than my share of time, Mr. Chairman, but I felt compelled to express these concerns.

Mrs. JOHNSON of Connecticut. The gentleman is making some very cogent points and the Chair would not want to seem limited.

Mr. STARK. If we must have tax incentives, then I think they have got to clearly be targeted to meet the need and they must be effective in meeting that need.

And I think we cannot ignore the poorest in this country and those most often denied even the basic skills to survive in higher technology jobs as well as high-skilled vocational training which is absent in the program. So, I look forward to the Secretary's testimony and I hope you will address these concerns, Mr. Secretary, and I think you will find today that other Members will have an interest in your program.

Thank you very much, Madam Chair.

Chairman ARCHER [presiding]. Thank you, Mr. Stark.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF U.S. Rep. JIM RAMSTAD
BEFORE THE WAYS AND MEANS COMMITTEE
March 5, 1997

Mr. Chairman, thank you for holding this important hearing on tax proposals aimed at education and training.

My home state of Minnesota is well represented at today's hearing.

David Longanecker, from the Department of Education, hails from Minnesota.

The distinguished President of Macalester College in St. Paul, Dr. Michael McPherson, will also be testifying.

And many students from Minnesota are sitting in our audience today, from the Minnesota State University Student Association and the Minnesota Community College Student Association. They represent hundreds of thousands of American students who in just a few short years will be leading our country -- in our communities, in business, and in government. We must not forget that this hearing is for them.

We all have a common goal of making education more affordable for American families. In the last Congress, this committee passed legislation to allow tax-free withdrawals from IRAs for higher education and a $2,500 deduction for interest on student loans. Certainly, the Administration's proposals deserve a fair hearing and careful examination.

Again, Mr. Chairman, I thank you for your leadership in exploring ways to make education more affordable for the American people.

—

Chairman ARCHER. Our first witness is Hon. Charles Rangel, the Ranking Democrat on the Committee. We are happy to have you as our lead-off witness, Charlie, and as I look to my left here I see that your cup of coffee is cooling, so I am sure you will not take too long. You may proceed.

STATEMENT OF HON. CHARLES B. RANGEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. RANGEL. Thank you, Mr. Chairman.

My dear friend and colleague, Mr. Stark, continues to refer to me as the secretary and I know the color-blindness of this Committee.

I just did not know how bipartisan it is. I am your buddy, Charlie Rangel. [Laughter.]

Mr. Chairman, I think that designing an education initiative could be the most exciting thing that has happened to me since I have been in Washington. I am not talking about the tax cuts or the Gingrich plan or the Clinton plan, I am saying that we have reached this point in our society that economic growth is dependent on our ability to be more competitive internationally. It is abundantly clear that we have moved out of an era of easy leadership. While we have provided the leadership and still do, there is a serious problem as to whether we Americans can continue to maintain our leadership and competitive lead without the training that other competitive nations are offering to their people.

Whether we are dealing in State capitals or our national capital, when we talk about our present educational system there is no excitement there. Teachers and training institutions find it harder than when waves of immigrants came here without money but with a lot of hope, knowing that access to education would allow them to exploit their potential and become successful in this great land of opportunity.

That is now gone. It seems the priority has become how many cops can we get, how many prisons can we get. My colleague from New York, Mr. Houghton, will tell you that in Albany the issue is not like it used to be for the Congress, how many unwanted military bases are they going to fund, but how many prisons can they get in the upstate area?

So, it is not a New York State problem that we are building more prisons than schools, more prisons than housing. It is a national problem and we are investing $6,000 or $7,000 a year for a kid in New York City—and even that is being debated now in the city council of New York—and no one dare challenges the $60,000 a year that we spend to keep a kid at Rikers Island in the detention center.

It seems to me that tax incentives are proposed to get businesses to be truly partners in what we are trying to do. Tens of billions of dollars are spent by multinational corporations preparing their own to meet the test of competition and technology. Unfortunately, we do not have the methodology, we do not have the experience, and we do not even have the initiatives within our public school system.

There are many who talk about vouchers—which really means that you have given up, that you would rather have the private sector come in and to take over the institutions that allowed so many poor immigrants to get their feet on the ground.

I think that a partnership between the private sector and our public school system, as well as our private school system would give us an opportunity, Pete, not only to look at the tax aspect but to look at the overall threat to our national security in saying that this great Nation is not keeping up. With the private sector giving us guidelines and enumerating the needs for the decades ahead into the next century, we can demand more of our educational institutions. They need to develop criteria that go far beyond intellectual ability but incorporates technology to keep us a world leader.

Now, it seems to me that if we go to the bargaining table internationally with 1.6 million people incarcerated—and if you add the drug problems to this, the unwanted children to this, the crime, the violence—we are talking about close to a trillion dollar burden that our trade negotiators go to the table with.

Instead, what we should be talking about is the number of people who we prepare to work, whether it is through college, whether it is by technical training, whether it is just making certain that when they get that diploma, they have an opportunity to get a job.

I told the President of the United States that this is the solution to the political problems that we have with the trade agreements. If you show the Members that represent areas of high unemployment that the schools and the training are available for them to participate in the rewards of the NAFTAs and the other fast-track trade agreements, and they would be the biggest advocates.

But, of course, if we are dealing with communities that have no training, oversized classrooms, where they are going to funerals more than they are going to graduations, where the diplomas are not given but certificates of attendance are given, where they know that there is no hope out there, where they know that doing drugs and making babies are not going to destroy what they never can even dream they can only hate trade agreements they think others benefit from. I am telling you, Mr. Chairman, that I am prepared to work with whomever you say to work with on whatever bill it is, to swallow whatever inequities may exist for one group, if we, as Republicans and Democrats can say that we are prepared to raise the standard of education in this country. I think education is the biggest investment that we can make in the national security of this great republic.

I stand ready to work with you, not to argue with anybody. I do not have a set agenda, but I will be looking to over 50 education directors of multinational companies and saying, come let us be partners, tell us what you need, help us to get it.

I know that it will be important to reduce class size, and let teachers teach. I have talked with the most outstanding union leaders we have in this country and they are ready to give up their hard-earned labor victories if we can just assure them that the classes will be smaller and that supplies will be there and they, too, would get the training to keep up with the necessary skills we need for the next century.

So, you can see that the opening statement that was given by my colleague is a little different from the way that I hope the Committee goes. There will be enough criticism in every proposal. But if we can develop a proposal that encourages everyone's opportunity for an education—college or no college—with the private sector saying that is what we need, we can reduce our taxes, increase our potential and become even a greater Nation.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Rangel.

Are there questions for Mr. Rangel?

Does any Member of the Committee wish to inquire?

[No response.]

Chairman ARCHER. Thank you very much, Mr. Rangel.

Our next witness is scheduled to be Senator Paul Coverdell and I see the Senator is here. Senator, please have a seat at the witness table. We are delighted to have you here with us. We will be most pleased to receive your testimony and I think you are probably aware of our rules that your oral testimony will be received. If you have any more lengthy written statement that can be inserted into the record without objection.

So, welcome to the Ways and Means Committee.

STATEMENT OF HON. PAUL COVERDELL, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator COVERDELL. Thank you, Mr. Chairman.

I am pleased to have the opportunity to visit with you and your distinguished Committee and very quickly because of time commend you for the great contributions you and this Committee are making to our country. I am one of those great admirers of the Chairman.

If I might, Mr. Chairman—I recognize that your jurisdiction deals with the tax consequences but I think a brief overview of S. 1 is in order.

First, S. 1 has a provision that deals with drugs and violence in schools and offers families, through a pilot program, the option of escaping from certifiably violent and drug-ridden schools. It provides local schools incentives to make their school districts safer and freer of violence.

It does have a number of provisions that make higher education more affordable and I will come to that in just a moment. One of the central provisions of the legislation, Mr. Chairman, is to eliminate among the most egregious mandates Washington has imposed on the educational system and local communities through the imposition of the 1970 legislation on special education, IDEA, the Individuals with Disabilities Education Act.

S. 1, over a period of 6 years, eliminates that mandate by funding the Federal portion of IDEA that was originally envisioned to be 40 percent of the cost. The Federal Government has never honored the commitment and is only funding approximately 7 percent of the cost.

And then the last provision, Mr. Chairman, deals with the promotion of adult education and family literacy. So, S. 1 is a broad ranging educational act.

I would simply say, Mr. Chairman, that with 40 percent of American students in elementary and secondary education fearful for their safety, with 60 percent of them arriving to college unable to effectively read, and with 20 percent of them bringing a weapon to school, we have a serious problem with regard to the Nation's ability to be educated.

And I might say, Mr. Chairman, that one of the guarantors of American freedom is an educated people.

With regard to the tax provisions, both the administration and Senate leadership have put forth comprehensive education proposals. While we agree on the need to assist families with college costs, we differ in our approach. The administration would provide large tax credits and tax deductions which critics argue will primarily benefit those students already attending college.

S. 1 would provide a long-term savings incentive to help families prepare for their children's future costs. The program would not expire and would have a 5-year cost of $1.8 billion.

The administration proposal would provide credits for current or immediate tuition costs. Experts argue that increased government tuition subsidies result in tuition cost increases. S. 1 contains a long-term savings plan that would not be tied to current tuition costs.

The President's proposal links receipt of his Hope scholarship to student performance. A child would only be eligible for the tax benefit if they maintained a B average. Critics are arguing that that puts in motion grade inflation.

S. 1 does not punish working or hardworking average students. None of the tax incentives in our bill places a judgment on academic achievement. We leave those matters to the family and to the college.

Under the President's plan, students become ineligible if their grades drop or if they commit a drug offense. Since the benefits come through reduced taxation, the IRS would have to monitor the student's performance and behavior.

S. 1 would use the current tax system to provide credits and incentives. Eligibility for the benefit would be determined by the law and not subject to school grading systems.

Under the administration's proposals, government control is the focus: Hope scholarships—government monitors the academic and personal behavior of the student. Direct lending changes—the government control over college loans is increased at the expense of the private sector, and college loan forgiveness benefits—available to students who work in charitable and government programs like the administration's new literacy program.

S. 1 does not increase government control. It allows families to save. It gives families the option of investing in a state college savings program or to save on their own to send their child to an in-state or out-of-state school; it allows the private sector and the States to help families with college costs; it encourages employers to provide education assistance to their employees.

Mr. Chairman, this past Monday at 5 o'clock in the afternoon, I and the members of the education task force on the Senate side met with Secretary Riley. This is my second meeting with the Secretary and we envisioned the creation, as the Chairman knows, of a working task force that would be bicameral and bipartisan singling out education as one of the five major areas with which the Congress and the administration see some common ground.

There are common issues, and I encourage, promote and look forward to these ongoing discussions. It would be my intention on any of the tax discussions to make this Committee completely aware of the findings that would result from any of these ongoing dialogs so that the Committee would have a constant and contemporary view of all those discussions.

I do think they are important and they are dealing with a subject of critical importance to the future integrity of the Nation.

With that, Mr. Chairman, I conclude my remarks. I hope that I have kept within the timeframe of this Committee and I would be glad to entertain a question or two if that is relevant.

Chairman ARCHER. Senator, thank you for some very excellent testimony and very thoughtful analysis of some of the major problems facing our educational system. We are very, very grateful to have that input.

Are there any Members who wish to inquire?

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Senator, as I said earlier, while we all have a lot of different ideas, I think the idea that the Congress and the President are getting involved in this on the national level breaks new ground. For so long, I have been allowed to believe that the education of American youth was a question of local school boards and that congressionally we had to keep our noses out of it.

I think now the President is providing leadership in recognizing that if we do not build an educated work force, it could threaten our economic growth. Having said that, I am working with a group of Members in different Committees here—so that we do not have turf problems. I am working with Republican leaders as well as our Democratic leaders.

I hope you would consider bringing together a handful of Members of the other body that have demonstrated an interest in this because I think our biggest obstacle is going to be who is in charge of the legislation.

There are so many different aspects of our educational needs spreading over some many different Committees that, since you have made the effort to come here, I would like to meet with you and see whether or not we can develop various proposals that—when we pull together this quilt—it will cover the needs of America, notwithstanding the fact that many Committees made contributions.

Senator COVERDELL. Well, Congressman Rangel, we have worked together on subjects in the past. I would certainly look forward to reenergizing or accepting your suggestion. The concept of the task force which was appointed by the Majority Leader in the Senate, was premised on the very point you just made, a recognition that the issue was multicommittee jurisdictional. It was an effort to facilitate those multiple jurisdictions and to move the issue to center stage. So, I accept that offer.

Now, the other point I would make and this was also reiterated by Secretary Riley, is that S. 1 still recognizes that the principal responsibility for education rests with the States, communities and parents. And nothing in S. 1 constitutes a mandate. It sees the Federal Government, I think appropriately, as a partner and a facilitator.

Secretary Riley, in all his remarks that I have heard, reconfirms this fundamental jurisdictional venue. Obviously, at least from my point of view, local States cannot determine international shortages—whether we have enough scientists or enough computer technicians to adequately compete. That is an appropriate Federal role.

I think that role was established by Secretary Bell very vividly when he wrote "A Nation At Risk." He was warning the Nation of a pending crisis with which we, of course, are confronted here today.

I will conclude by simply saying that our office will be in touch with yours within the week. We will have to see how we might facilitate the discussions you invited.

Mr. RANGEL. And I will bring the partnership of the business sector with whom I am working very closely. They can give us their agenda for the next century.

Mr. Chairman, has the Speaker appointed an education task force, to your knowledge in the House?

Chairman ARCHER. Not to my knowledge.

Mr. RANGEL. Well, I hope we can join in asking him to do it. I would ask to serve on it if you see fit to appoint Members to it.

Thank you.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Chairman, I just wanted to join with you and the other Members of the Committee in welcoming my colleague and friend, Senator Paul Coverdell, from Georgia. I had the pleasure of serving with Senator Coverdell when he was Georgia State Senator and I am well aware of his commitment to education, to families, to children, and also his commitment to economic growth. It is with pleasure that we welcome him here today. And also his most capable and dedicated assistant Molly Dye.

Thank you, Mr. Chairman.

Senator COVERDELL. Thank you. It is true that Congressman Collins and I have served together in the Georgia Senate. Those days were a little more peaceful than up here, but it is always good to see my good colleague from Georgia.

Thank you for the welcome.

Chairman ARCHER. Mr. Levin.

Mr. LEVIN. Senator, welcome. I just wanted to say a quick word. I think the spirit of your testimony is very much welcomed and appreciated by everybody on this Committee.

And I hope that we can proceed not only on a bipartisan basis and bicameral but with kind of an open mind on these issues and not bring too many of our preconceptions.

Let me just give you one example and that relates to special education. There was a mandate, and we should no doubt take a look at that mandate, that is now 25 years old or so, but in doing so I hope we will take a look at where this country was in the late sixties and early seventies in terms of educating handicapped children.

In the midsixties, late sixties, when I was in the State Legislature in Michigan, we discovered that more than half of the children who had a handicap, physical or emotional or mental in Michigan, did not have a single hour of classroom opportunity. That was more than half. And we took some action but what was true in Michigan was also true in most States of this Union, and I think the verdict is somewhat clear that if there had not been a national commitment to educating handicapped kids, today we would be in a very different position than we are.

And that mandate did not mean basically that Washington was running the handicapped classroom, that was still done within the local community. The mandate was that local communities should educate handicapped children.

So, as we kind of take out our conceptual swords I just hope that we will take an open-minded look at that issue and other issues.

Senator COVERDELL. Well, I appreciate the comments from Congressman Levin. Let me say that S. 1 accepts the value, so to speak, of the mandate, but simply deals with the fact that the Federal commitment to help fulfill the mandate was never honored. And, so, S. 1 envisions us meeting the financial requirements that were suggested to the States at that time.

And it would move the Federal portion of the funding for IDEA to the 40 percent level that was originally envisioned but never done.

Now, separate and apart from S. 1, in the Labor and Education Committee is separate legislation that deals with IDEA or special education. I have not reviewed the details of the legislation but conceptually understand it to be pointed toward flexibility for the local systems because as it has emerged and matured, while its goals were very laudable and continue to be, we have discovered issues that have constrained some of the logical management of the situation in the local school district area.

Congressman Levin, I will say this, that I do not visit with a education board member or principal who is not talking about this mandate, they are not talking about retrenchment, but they are talking about management tools that they need. So, that would be apart from S. 1 and it may be as Congressman Rangel suggested, because of the inner involvement with education, that we ought to maintain close communication with those Committees' works as well.

Mr. LEVIN. Good. I very much agree with that spirit, thank you, Mr. Chairman.

Chairman ARCHER. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Senator, I wanted to get your thoughts on Georgia's Hope Program, if you have looked at the program and get your perspective on it. And, also wanted to hear how you thought they monitored the program as far as what the President has proposed to us with the IRS monitoring grades of a B or better.

Senator COVERDELL. Well, first of all, I guess one of the essential differences would be that the Hope scholarships in the State of Georgia are funded from a nongeneral funding source.

They are funded by a lottery which is a whole separate issue. But that is the source of all funding for Hope scholarships.

I would have to say that they have been generally well received by the community and the utilization is extensive. My guess is, although we have not had sufficient time to truly measure it, that any program that is grade related will ultimately have the effect of grade inflation. I just don't see how it can be avoided.

It has always been a conflict of mutual goals. I have always believed we ought to have incentives, strong incentives for people to be better achievers. But I also recognize that there are students who are very disciplined and who are endeavoring to do their very best to achieve but they are not in the top 10 percent.

And I have always had a nagging question for myself that I have never fully resolved as to why a family that happened to be the proud parents of one of those children would be denied assistance

in higher education because of the natural, natural constraints on the asset that God gave that child.

So, I have always had a bit of a conflict over that point.

Mr. CHRISTENSEN. OK. A couple of things that some of the reports I have looked at in terms of the Hope scholarship. First of all, it tends to favor, obviously, the Caucasian, the Asian, it disproportionately affects those that are in the affirmative action sector.

Other concerns that I would like to hear your thoughts on are first of all, should it be on a need-based program as far as if we were to follow through with the Hope scholarship, even though I most likely believe that right now our high schools, K through 12 are what we need to focus on and put some efforts into major repair rather than focusing on a 2- or 4-year type of a program in postsecondary. The public school systems in our inner cities today are a disgrace and we need to focus on that.

Senator COVERDELL. Well, clearly, Congressman, there is no higher education system that is truly competitive with that of the United States. And the essence of the breakdown for education in America is in elementary and secondary levels, the problems outside of an acknowledged concern for this with less means getting the college education. The crisis, and it is a crisis, is at the elementary level.

And the majority of S. 1 is pointed at that crisis. It does have sections that relate but, as I said in my testimony, its emphasis for higher education is to encourage people to plan and to facilitate that planning versus an immediate reward for somebody who is essentially already there.

But as Congressmen Levin and Rangel have said or suggested, we are at the preliminary stages of these discussions and we ought to hear out everybody.

Mr. CHRISTENSEN. Thank you, Senator.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Senator, just in this discussion, I know some of this is not within the jurisdiction of this Committee, but education is, as Congressman Rangel talked about, all of our concern and hopefully a lot of the turf battles will not occur on education that normally occur up here. But following up with what my colleague from Nebraska was talking about, having been in the business world and seeing the type of graduates that we have coming out of high school and literally coming out of college today, it is not, yes, there are some problems with them maybe not being technically trained well enough, but a bigger problem from my own perspective being in the business world but also from the perspective of a lot of other businesspeople that I have talked with, are the basics.

People do not have the basics to be able to train on top of, you know, to get the computer skills, to get the other skills, the technical skills on top without—it is kind of like building, you know, in scripture where it talks about building a foundation on sand, when the rains and the floods come it just washes it away.

If we do not have the foundations built in the public school system, of the basics of the three Rs, that it seems to me that all of

the Hope scholarships, all of the things that we are doing in college are, well, very difficult to have very much success with. We are going to have to spend a lot more money and we will end up doing what Congressman Rangel talked about, throwing more money at prisons.

My question would be, though, is that we are talking about the Federal role in education now. How do we see an effective role for the Federal Government in education? It seems to be statistically, the more the Federal Government gets involved with education, the more we have dumbed down our schools, the more that those public schools are not teaching the basics in education. You know, I forget where I was hearing this the other day, but it was since the beginning of this century literally one grade every 10 years we have dumbed down.

I mean there are people that graduated from high school today that cannot pass third grade, fourth grade tests from the beginning of this century.

So, you know, philosophically, we want to do something here, we all want to feel good about what we are doing here, but what can we do from the Federal level to truly have an effect and not just make legislators feel good about what they are doing?

Senator COVERDELL. Well, first of all, let me say, Congressman, I essentially agree with your frustration and I think it is well vented. I have said that we can do whatever we want in schools but an American family has to expect the fundamentals. That a child who graduates from high school must be able to read, to write and to add and subtract.

Everything else they can try to impose what they choose, but the basics must be done. And I think in essence, that is what you are saying.

Now, the Federal role, as I said, is a partner and not a boss. And I believe that it is a Federal role to do what we are doing here which is to alert the families and citizens of our country that we have a breakdown. I think we have a responsibility about the general state of the Nation.

And when a fundamental issue that impacts the security and health of our Nation is in jeopardy, I believe that, as Federal officers, we have a right to be speaking to it.

I believe S. 1 outlines the appropriate role. It talks about the problem, it frees up Federal mandates so that local communities have resources to do the job they need to do and it states that families must not be forced in America to go to drug-ridden schools. And it becomes a partner on literacy and adult education and it becomes a partner in tax planning for a family to prepare themselves for higher education.

It is just as important to say what it does not do. There is no mandate in the measure. There is no enforcement provision to force a citizen or a school or State to do anything. It is a partner. We know there is a problem, and I think we are obligated to help just as if there were a natural disaster. This is a disaster.

Thank you for your question.

Mr. ENSIGN. Thank you, Mr. Chairman.

Chairman ARCHER. Are there any other questions for the panel?

[No response.]

Chairman ARCHER. Evidently not. Senator, thank you so much, it was excellent testimony and excellent colloquys with Members of the Committee.

Senator COVERDELL. Thank you, Mr. Chairman and thank you again for the good work you do.

Chairman ARCHER. Our next witnesses are a panel of two of our colleagues from North Carolina, Congressman David Price and Congressman Bob Etheridge.

If you will come to the witness table, we will be pleased to hear your testimony.

I am sure you two gentlemen are aware of the rules of our Committee that we would like for you to keep your oral presentation to 5 minutes or less and your written presentation or testimony can be included in full in the record without objection.

Would you lead off, Mr. Price?

STATEMENT OF HON. DAVID E. PRICE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. PRICE. Thank you, Mr. Chairman.

We appreciate the opportunity to testify here this morning and we commend the Committee for the attention you are paying, the serious attention to education affordability.

I appreciate the chance to talk with you briefly about the Tax Code as it relates to higher education. I have been a professor of political science and public policy for 19 years, I am the father of two recent college graduates, so,

I do know firsthand how important higher education is to our young people and also how much it has come to cost.

Today I want to discuss how we can adjust our current tax policies to help with this critical issue that we face as a Nation, educating our young people and training our work force. Specifically what we want to talk with you about today is a bill that Bob Etheridge an I have introduced, H.R. 553, the Education Affordability Act.

This bill would amend the 1986 Tax Code to make education more accessible and affordable for students and their families.

In the last decade, as you well know, the economics of higher education have become more grim. Adjusting for inflation, the median income in America has remained stagnant, while college costs have soared, over 25 percent for public education and 40 percent for private universities, placing higher education out of reach for many working families.

I am pleased that higher education has finally reached the radar screen of both the executive and legislative branches of this government because as I talk to those that are leading large and small companies across my district, I hear how important a trained work force is to their enterprise.

Without skilled workers these companies cannot compete in an international market and without a trained work force, areas like the Research Triangle of North Carolina cannot expect our economic success stories to continue.

All of this means that we are at a critical point in terms of public policy. It is quite basic. If we want to compete in the global marketplace, we need to train our workers. And tax policy, I believe is one

area where we can take significant steps to address this higher education crisis.

Unfortunately, the current Tax Code does not reflect our urgent need to train our work force. In 1986, Congress created a simpler and fairer Tax Code but tax reform was not entirely consistent in the way it picked and chose among credits, deductions, and exemptions. And the incentives it provided have gotten increasingly out of line with some of our country's most pressing needs.

The Education Affordability Act would help bring our Tax Code in line with our growing emphasis on education and work force training, would help families save for and then finance higher education. Our bill has three easy-to-implement provisions.

First, the bill would restore the deductibility of interest on student loans. Currently, a family can deduct their mortgage interest. Isn't going to college as important, as basic as owning a home, let alone owning a second home at the beach?

Families ought to be able to deduct student loan interest in the same manner, making borrowing more affordable.

Second, the Education Affordability Act would fully exempt scholarships and fellowships from taxable income. If your child receives a $500 scholarship for tuition currently that is tax exempt. However, if your child is lucky enough to receive a scholarship covering living expenses or work-study fellowship, he or she would be taxed on the portion of this award that is not directly used for tuition.

We all know that tuition is only part of the expense of sending our children to college, and that we shouldn't penalize students who work hard and are given scholarships for college by then taxing them on these awards.

Last, H.R. 553 would allow families who have individual retirement accounts to draw down money penalty free for higher education purposes. Waiving the current 10 percent fee for early IRA withdrawals would encourage working families to save for their children's education if families saved more they would have to borrow less. This provision would not set up a new type of IRA, nor would it create a new government program. Instead it would use the existing savings infrastructure to facilitate savings for higher education.

Overall, the Education Affordability Act is a important step in changing the Tax Code to open up the doors of educational opportunity and to train our young people for the work place of tomorrow.

As I mentioned before, I am pleased we have a President who is committed to improving our Nation's competitive position by educating our workers. I think his proposal for tax credits and deductions for higher education is extremely important to providing affordable education to students, especially for those first 2 years beyond high school that are becoming almost a requirement for a good job in this country.

I am also pleased to learn more this morning about Senator Coverdell's proposal. The bipartisan effort here is quite impressive and I am pleased that this Committee is giving such serious attention to the full range of measures.

I have introduced bills similar to the Education Affordability Act in three previous Congresses. Members on both sides of the aisle

have cosponsored these measures in the past and they are doing so again. The provisions included in the Education Affordability Act are truly the least we can do for our students who want to pursue a college education and, therefore, in turn, improve their chances in an increasingly competitive job market.

Any education tax relief bill that we pass in this Congress, should include these three important provisions: student interest deductibility, tax-exempt scholarships and penalty-free IRA withdrawals.

Thank you for your attention, I would be happy to answer any questions that you may have about this bill or its implications for higher education.

[The prepared statement follows:]

Statement of Hon. David E. Price, a Representative in Congress from the State of North Carolina

Good morning. I appreciate the opportunity to talk to you about the tax code as it relates to higher education. As you may know, teaching is my career. As a professor of political science and public policy for 19 years and as the father of two recent college graduates, I have seen first hand how important higher education is to our young people and how much it has come to cost.

Today, I want to discuss how we can adjust our current tax policies to help with a critical issue we face as a nation: educating our young people and training our workforce. Specifically, I want to acquaint you with a bill that I have re-introduced with Congressman Bob Etheridge, H.R. 553, the Education Affordability Act. This bill would amend the 1986 tax code to make education more accessible and affordable for students and their families.

In the last decade, the economics of higher education have become more grim. Adjusting for inflation, the median income in America has remained stagnant, while college costs have soared—over 25% for public universities and 40% for private universities—placing higher education out of reach for many working families.

I am pleased that higher education has finally reached the radar screen of both the Executive and Legislative Branches. As I talk to those leading large and small companies across my district, I hear how important a trained workforce is to their enterprise. Without skilled workers, companies cannot compete in an increasingly international market, and without a trained workforce, areas like the Research Triangle of North Carolina cannot expect our economic success story to continue.

All of this means that higher education is at a critical point in terms of public policy. Its pretty basic: if we want to compete in the global marketplace, we need to train our workers. Tax policy is one area where we can take significant steps to address this higher education crisis. Unfortunately, the current tax code does not reflect our urgent need to train our workforce.

In 1986, Congress created a simpler, fairer tax code. Tax reform was not entirely consistent, however, in the way it picked and chose among credits, deductions, and exemptions. The incentives it provided have gotten increasingly out of line with some of our countrys most pressing needs. The Education Affordability Act would help to bring our tax code in line with our growing emphasis on education and workforce training and would help families to save for and then finance higher education.

Our bill has three easy-to-implement provisions: *First,* this bill would restore the deductibility of interest on student loans. Currently, a family can deduct their mortgage interest. Isnt going to college as important, as basic, as owning a home, let alone a second home at the beach? Families should be able to deduct student loan interest in the same manner, making borrowing more affordable.

Second, the Education Affordability Act would fully exempt scholarships and fellowships from taxable income. If your child receives a $500 scholarship for tuition, currently this is tax-exempt. However, if your child is lucky enough to receive a scholarship covering living expenses or a work-study fellowship, he or she would be taxed on the portion of this award that is not directly used for tuition. And we all know that tuition is only part of the expense of sending our children to college. We should not penalize students who work hard and are given scholarships for college by taxing them on these awards.

Lastly, H.R. 553 would allow families who have Individual Retirement Accounts to withdrawal money penalty-free for higher education purposes. Waiving the cur-

rent 10% fee for early IRA withdrawals would encourage working families to save for their childrens education. If families saved more, they would have to borrow less. This provision would not set up a new type of Individual Retirement Account, nor would it create a new government program. Instead, it would use the existing savings infrastructure to facilitate savings for higher education.

Overall, the Education Affordability Act is an important step in changing the tax code to open up the doors of educational opportunity and to train our young people for the workplace of tomorrow.

As I mentioned before, I am pleased that we have a President who is committed to improving our nations competitive position in the global marketplace by educating our workers. His proposals for tax credits and deductions for higher education are extremely important to providing affordable education to students, especially for those first two years beyond high school that are becoming almost a requirement for a good job.

I have introduced bills similar to the Education Affordability Act in three previous Congresses. Members on both sides of the aisle have cosponsored these measures in the past and are doing so again. The provisions included in the Education Affordability Act are truly the least we can do for our students who want to pursue an college education and, in turn, improve their chances in an increasingly competitive job market. Any education tax relief bill that we pass in this Congress should include these three important provisions: student interest deductibility, tax-exempt scholarships and penalty-free IRA withdrawals.

Thank you for your attention. I would be happy to answer any questions that you may have about this bill or its implications for higher education.

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Chairman ARCHER. Thank you, Congressman Price.

Congressman Etheridge, you may proceed.

STATEMENT OF HON. BOB ETHERIDGE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. ETHERIDGE. Thank you, Mr. Chairman.

I appreciate the opportunity to speak on behalf of this legislation that my good friend, David Price, and I have introduced. Let me join him in commending you, Mr. Chairman, and Members of this Committee for taking up what I think is one of the most important issues this Congress could deal with in this legislative session beyond the protection of our borders. Because, I think this bill will help protect this country's future for a long time to come.

I appreciate the opportunity also to talk to you about this bill because I think that enhancing education affordability is one of the things we need to do to help people obtain the schooling and training that they are going to need as we approach the information and technological age that we are moving into now and in the 21st century. This a tremendous challenge this country has not faced in a very long time.

Mr. Chairman, and Members of the Committee, I am a freshman member of this body. I am proud to be here. Prior to my being sworn in about 2 months ago, I served for 8 years as the elected State Superintendent for the schools of the State of North Carolina.

In that job, I had the tremendous responsibility for helping educate the young people and ensuring that our State's next generation would be equipped to face the tremendous challenges that they face in the ever-changing world.

And, let me say to you this morning that we have enjoyed some success in that challenge. Some of you may have seen, just this past week, Education Secretary William Riley designated North Carolina as the winner of the most improved player award in the

widely regarded National Assessment of Education Progress. The assessment measures the fourth and eighth grade mathematics, and our eighth graders gained more than any State in the Nation since the last assessment in 1992.

We are tremendously proud of the hard work of our students, our teachers, the support of our local communities and business partners that have made this success possible.

But as important as these scores are, good scores do not mean a thing if a child cannot use them to fulfill his or her God-given ability to continue the lifelong progress toward education, higher education and beyond. Today, that means getting a college education. More and more, college degrees are a prerequisite for any job that is available.

Yet, the cost of higher education often puts those hopes beyond the reach of many middle-class families. I will not reiterate some of the points my colleague, David Price has already made. But I will say to you I think it is important, I commend this Committee for taking a look at education and the way you want to do it across the aisle beyond the partisanship. Having served for 8 years I can tell you that no matter what we do in the halls of this Congress, no matter what happens in State legislatures or even at boards of education and county commissioners, the action will take place in the classroom and our schools today, ladies and gentlemen, are far better than they are being given credit for. Our teachers are working hard. They need, as John Wooden, a great coach whom I greatly admired, said one time to his players many years ago, he said, "Young people need supporters not critics."

And our teachers need some of that today as hard as they are working. This bill will start the process. We will roll back, I think, some of the penalties we put in back in the eighties when we disallowed the deduction for interest and other things, to allow our hardworking parents to have a chance. Congressman Price and I met with students from a number of our universities several weeks ago. I would say to you that if you have never had a chance to meet with young people who are either in college or getting ready to go, you are going to be surprised at the number of those young people, not just their parents, but young people are working jobs to save money to get into school and they are coming out of college with tremendous debt. We can help change that in 1997.

I want to be a part of that. I know you do. I look forward, Mr. Chairman, to working with you and in conclusion, let me again congratulate you on for looking at these issues that I think are so important, making options of college education affordable for America's hardworking families.

I believe that this Congress can take on no greater mission in 1997, and as Members of this Committee from both sides of the aisle, let me congratulate you and thank you and, Mr. Chairman, I will be happy to try to answer any questions you might have.

[The prepared statement follows:]

Statement of Hon. Bob Etheridge, a Representative in Congress from the State of North Carolina

Thank you, Mr. Chairman for the invitation to testify on behalf of this legislation my good friend Mr. Price, and I, introduced on February 6 to help America's working families afford the increasing costs of higher education. I appreciate the oppor-

tunity to present to you this bill that will make such a difference in helping people attain the schooling and training they need to succeed in an information- and technology-based economy.

Mr. Chairman, I am a freshman Member of this body. Prior to my swearing-in two months ago this week, I served eight years as North Carolina's Superintendent of Public Instruction. In that job, I held the tremendous responsibility for educating our young people and ensuring that our state's next generation would be equipped to tackle the challenges of an ever-changing world.

We have enjoyed some success. Some of you may have seen that last week, Education Secretary William Riley designated North Carolina the winner of his "most improved player award" in the widely respected National Assessment of Educational Progress for eighth graders. We are tremendously proud of the hard work of the students and teachers and all the support of our local communities and businesses that made such an achievement possible. But as important as they are, good scores don't mean a thing if a child cannot use them to fulfill his or her God-given abilities.

Today, that means getting a college education. More and more, a college degree is a prerequisite for a good job and the hope of a decent future, the beginning of life-long learning. Yet, the cost of higher education often puts those hopes beyond the reach of many middle class families.

Over the past decade, the price of a public college education has increased 27 percent and a private college by 40 percent while wages have stagnated. Working families often must spend more than one-quarter of their hard-earned income on putting the kids through college. As the great educator Horace Mann said, "Education is the great equalizer" in this country. If we are going to ensure equality of opportunity for all, we must find innovative ways to make higher education more accessible and more affordable for hardworking, middle class families.

Our bill, H.R. 553, the Education Affordability Act, helps do just that. There are three simple components of this legislation to provide some tax relief for consumers of higher education. The first two provisions un-do part of what was done to the tax code in the Tax Reform Act of 1986. Specifically, we would restore the deduction for interest on student loans (making them like home mortgage interest—the other big expense families face), and we would restore the provision making scholarships and grants fully tax exempt. While I understand that the 1986 legislation was intended to lower overall tax rates by closing deductions, it has resulted in denying working families the opportunity of an affordable college education.

The third piece of our bill is also contained in President Clinton's education proposal. This provision allows penalty-free withdrawals from Individual Retirement Accounts to pay for higher education. Working families have a hard enough time saving any more. So we should do anything we can to create incentives for them to save for education. The President estimates under this provision (coupled with his $10,000 tax deduction) higher education will never be taxed for most families. By capping this provision at families making $100,000, the President estimates that over 20 million American families will be eligible for this benefit.

Mr. Chairman, on February 3, Mr. Price and I traveled to the campus of North Carolina State University to meet student leaders for an informal discussion about the challenges they—and their families—face in paying for school. Students from NC State, the University of North Carolina—Chapel Hill, Shaw University, Duke University, Campbell University, Elon College and Meredith College attended the event and gave us their first-hand account of the difficulties working families face in meeting the ever-rising costs of higher education.

Mr. Chairman and distinguished Members of the Committee, I strongly encourage you to go out in your home districts and meet with college students, those who aspire to be college students and their parents and other family members. Let them tell you, like our constituents told Mr. Price and me about the challenges they must overcome just to afford the education that now is a requirement for an entry-level job on the bottom rung of the career ladder. I am confident you will emerge from such an encounter ever-more resolved to pass meaningful legislation that will make a real difference for America's working families. We strongly believe that H.R. 553, the Education Affordability Act, is a good step in that direction.

Mr. Chairman, in conclusion, let me congratulate you for convening this hearing to examine this Congress's options for making college education affordable for America's hard-pressed families. I believe that this is the greatest mission Congress could undertake, and I look forward to working with Members of the Committee from both sides of the aisle to make such an important accomplishment a reality.

Thank you Mr. Chairman and Members of the Committee.

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Chairman ARCHER. Thank you, Congressman Etheridge.

Is there any Member of the Committee who wishes to inquire?

Mrs. Johnson.

Mrs. JOHNSON of Connecticut. I thank you for your testimony and Congressman Price for your many terms of leadership in proposing legislation along the lines you described today.

I do want to make clear on the record, because I think all of us across the Congress, are going to have to be honest and realistic about these things. We did actually restore deductibility of $2,500, the right to deduct $2,500 in interest and also to make penalty-free withdrawals for education purposes in bills that got as far as the President's desk in the last session.

They were part of larger bills and because these issues have to be funded they are going to have to be accompanied by funding sources. And traditionally that has meant the budget.

So, I think we have an opportunity in this session to come to terms with passing a balanced budget and in the process of that including some tax losses, tax expenditures as some call them, for the purposes of helping families carry the burden of education. That is a position I support. But I do want to say not only has there been a lot of legislation introduced in the past, but there has been a commitment sufficient commitment to actually include deductibility of at least a significant amount of interest per year, $2,500, which covers a lot of loan money and penalty-free withdrawals in the last 2 years, twice going to the President. So, we are going to have to work together on that base bill so that we can include in it some of the things that we know are important.

And I also just wanted to put on the record that in 1986, we did allow the deduction of scholarships and fellowships in, to the extent that they pay tuition. To the extent that there is a work requirement attached, for instance, for a teaching fellowship, some of that money is seen as compensation for work and, therefore, taxable.

I think we will have to weigh whether we want to go beyond tuition to excluding what is work compensation given the other alternatives.

So, I thank you for your ideas. There are some other ideas out there as well, including the President's and this is an opportunity for us to work together across Committee jurisdictions and across party lines but it is going to mean that we have to be really deadly serious and honest about trying to get to a budget that will meet the balanced budget goals of the 5-year period.

And in that one small regard, I am sorry that the President's budget is not more realistic, but I think we have proven ourselves to be capable of making the choices that are required in that discipline. And I personally think that better support of education is imperative and is supportable in the context of our commitment to a balanced budget.

Thank you.

Mr. PRICE. Thank you, Mrs. Johnson.

It is true that a number of these ideas have come very close to passage in the past. You may remember that in the 1990 budget agreement, for example, we came very close to being able to include

an interest deductibility provision. So, these are not foreign ideas, these are ideas that we should be able to get broad consensus around. And, of course, we would totally agree with your point about the need to fully pay for these provisions in the context of an overall budget agreement.

Chairman ARCHER. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Gentlemen, nice to see you, Dave, good to have you back.

Mr. PRICE. Thank you.

Mr. HOUGHTON. I obviously do not disagree with the basic thrust of your argument. There is not any question about it that we spend far too much on seniors and far too few dollars in terms of our younger people and the future.

But I want to ask you a question because I think we talk about education and training tax provisions and more money and be able to put less burden on the student.

What about the colleges and the universities? I remember a study by the Carnegie Corp. several years ago that indicated that inevitably the cost of education would go up between 2 and 3 percent higher than the CPI. And you just assume that there will be no cost reductions, no efficiency in the educational atmosphere. So, therefore, more money is required either by the government or the families or the individuals or the banks and there is no reign in terms of anything which the colleges do.

Have you got any comments to make there?

Mr. PRICE. Well, I think your point is well taken about the need for partners in this struggle to keep education accessible to families at all income levels. In our State, our State university system has struggled mightily to keep tuition costs down and North Carolina taxpayers have basically been asked to share the cost of that in keeping tuition accessible to families.

And as someone who has taught in a private institution, I can certainly testify as to the constant fundraising activities there that have helped buildup an endowment and scholarship funds so that education at that level is more accessible, as well. So this struggle is underway but certainly what we are talking about here is only a piece of that effort, although we think an important piece in terms of Federal tax policy.

Mr. ETHERIDGE. Let me just add to that. Because of the Carnegie study that you talked about there is extensive work going on now by the Education Commission of the States and I assume the other study groups. The Southern Regional Educational Board is also taking it on working with colleges and universities around this country to look at their infrastructure, how to cut the costs, and assist students who are striving to move on to the university because of the continuing escalation of costs.

We have one private college that happens to be in my district in North Carolina, that actually cut their overall costs this past year as a way to attract more students. And it is a little early to know what that is going to do to their bottom line but it did one thing: it increased the number of students. And I think these are some of the things we are going to see a lot of the universities starting to pay attention to because the cost is continuing to escalate.

Mr. HOUGHTON. Well, thank you very much, and I have a little more time and I just want to explore this a bit further. I do not know how many billions of dollars are raised every year by higher education but it is an enormous amount. Most of that money though goes into buildings, grounds and endowed professorships, a variety of different things like this.

Not a large percentage goes into scholarships. And I just wonder when the Federal Government is getting in here, whether there shouldn't be a sort of matching or a quid pro quo as we look at this overall target?

Mr. PRICE. The fundraising that I know about in both public and private institutions in our State has gone, of course, for a range of needs including endowed professorships, facilities, equipment. In the cases I am best acquainted with, a good portion of that and I can give you the exact figures if that proves relevant for scholarship and fellowship aid, for work study, especially at the graduate level. That is such a pressing need.

These graduate students hanging on by their fingernails financially, piling up years and years of debt. There is a need for more university attention to the situation of these students and as we are saying here today there is need for a better Federal tax policy so that we are not adding a tax burden on top of these financial obligations.

Chairman ARCHER. The gentleman's time has expired.

Does any other Member of the Committee wish to inquire?

If not, the Chair will.

Mr. Jefferson.

Mr. JEFFERSON. Gentlemen, let me ask you a question. The proposals you make, these three, do you propose these on top of the President's suggestions or do you propose them instead of his suggestions? And do you think these are more important, the ones that he is proposing? In other words, if you have to kind of pick and prioritize, which are the most important if you were able to judge those?

Mr. PRICE. There is some overlap both with the President's package and also with the package developed by our friends in the Senate. And the penalty-free drawdown of IRA accounts, for example, is part of the President's package, as is deductibility for interest on loans.

So, we are not claiming that this is a totally new or novel package, nor are we claiming that it is complete. Speaking for myself, I am particularly interested in the President's Hope scholarships that offer those tax credits in those 2 years just beyond high school. And those credits would be available to people whether or not they itemize deductions. So, we are not claiming this is a complete package, but we do think it is kind of a bottom line package in the sense that whatever we do in this area certainly should contain these items or something like them in offering this kind of basic tax relief.

Mr. ETHERIDGE. I would concur and I would hope that as the dialog continues over the next several months and we put a package together that whatever pieces of this are part of another one we develop a much larger education package than what we have right

here. Because I think there is a lot to be done at the elementary level that is crying out for help in this time.

Chairman ARCHER. Does any other Member wish to inquire?

If not, the Chair will conduct a closing, very brief inquiry.

Gentlemen, you have not said whether you are in 100 percent support of the President's proposals. And I would like to ask each of you whether you are, or are not, in support of the tax parts of the President's educational proposals.

Mr. PRICE. I am basically supportive of the President's proposals. That does not mean they should not be scrutinized and in some instances, possibly refined. But I think basically it is a sound package. I think it is consistent with what we are proposing here. And, so, I would hope that that package could move forward but, of course, this Committee and the Congress, as a whole, will want to look at those proposals carefully, assess their impact and make whatever refinements are called for.

Chairman ARCHER. The purpose of these hearings is to try to get as many precise comments as we can on various parts of the proposal, and with your experience and educational background, could you tell us the areas where you might be concerned and that you would want to change in the President's proposals?

Mr. ETHERIDGE. Mr. Chairman, thank you.

I would be very candid and say I have not read it in detail but I would be happy to do that and come back at a later date. There are pieces of it that I have looked as he made his presentation earlier and I have just viewed it in a very quick passing.

I think the opportunity to provide for students the hope, the opportunity they can go on to school within the context of getting to our balanced budget is so important that and there are so many young people today who want an opportunity to go on to school. Having said that——

Chairman ARCHER. Generally I think all of us would agree with that, but can you specifically point out any provisions that you have particular concern about that you think need to be changed?

Mr. ETHERIDGE. Not at this point, but I would be happy to if I get a chance to go into detail. I would hope that as we provide opportunities for children to get an education at the university, the Hope scholarship is a great piece. I like that. I think it provides some opportunity for the middle class but I want to make sure and I hope this Congress would make sure there are enough Pell grants and other assistance for the need-based student. I have heard a lot of that from my universities that are in my district.

Chairman ARCHER. OK.

Mr. PRICE. Mr. Chairman, if you are looking for some sense of priorities I certainly think whatever we can do to raise the maximum award for Pell grants so as to improve the mix of loans and grants, I think the Hope scholarship, the tax credit approach is good. And I think it is especially important to extend that tax exclusion for employer-provided education assistance. The so-called section 127 provisions. Those would be very high priorities.

It has all got to be put in context though of our budget goals as Mrs. Johnson indicated, and, of course, we think that these tax provisions that we have talked about here today are particularly important building blocks of a comprehensive approach.

Chairman ARCHER. Congressman Etheridge.

Mr. ETHERIDGE. Chairman Archer, one point I would make as it relates to K through 12, having spent some time there and let me say to the Members of the Committee that my background is in business. I spent 20 years there before serving as superintendent of the schools.

We have schools in this country that do have some very bad infrastructure and our State just passed a $1.8 billion bond issue in a match with locals to help, which is unusual for a State. But the technology and access to technology for a lot of our schools in rural areas and even in some of the urban areas is really important in the current time.

And I would strongly support that piece of it. Anything we can do to help that process, because what we see and I have seen it in school after school as I visited as I am sure many of you have, is that in the schools that have the resources, the students tend to do better. That is so for a lot of reasons.

One reason is they have got parental support. And I guess if there is anything we can do to reach out to the business communities and others to encourage that parent to be involved but technology is a critical piece of the effort. It is not a substitute for a good teacher in front of that classroom. It is not a substitute for students learning the basics but it certainly can be an aid to that teacher in helping in that process.

Chairman ARCHER. Well, I understand from both of your comments that you, in effect, would support the full $35 billion revenue loss that is involved in the President's package. Is that a fair statement?

Mr. PRICE. No. It is not a totally fair statement in that——

Chairman ARCHER. I see Congressman Etheridge nodding.

Mr. PRICE [continuing]. Our statement indicated a favorable disposition toward the President's proposals. We, of course, will, along with other Members, await the judgments of this Committee as to what those priorities might be and what the revenue implications are, and what the overall package ought to look like. I do not think any of us are prone to give the President or anyone else a totally blank check in this area.

Chairman ARCHER. I was kind of hoping you would help us set some of those priorities but you——

Mr. PRICE. We tried to indicate, Mr. Chairman, what we think should be at the top of the list.

Chairman ARCHER. The Committee would be pleased to receive anything in writing that you would like to give us to help us in establishing those priorities, particularly with your educational background.

Mr. ETHERIDGE. I would be happy to.

Chairman ARCHER. Have you had scored at all the revenue loss from the proposals that you are suggesting? I would assume that you would suggest those in addition to the President's proposal rather than to replace a part of the President's proposal.

Mr. PRICE. Well, the President's proposal, as we understand it and also Senator Coverdell's proposal includes a good number of the items that we are proposing. The best estimate we can come up with and it is a tentative estimate—we do not have a current

scoring estimate from CBO—the best estimate we can come up with is approximately $600 million per year in revenue losses from our package, which, of course, is far, far less than the President's proposal, as a whole.

Chairman ARCHER. OK. Can you tell the Committee what parts of your package are not included in the President's proposal?

Mr. ETHERIDGE. The President's proposal does not include—as I understand it, now, I have not read all the fine print, I am not sure we have access to all the fine print—the President's proposal, as I understand it, does not do as much as we would like to do in the area of tax exemption for scholarships and fellowships. But I would also say that is the least expensive portion of the three-part package that we are talking about.

I think that the President's proposal does essentially what we would like to do in the area of IRA drawdowns as does Senator Coverdell's package. In terms of deductibility on student loans, there may be a cap on that in the President's proposal, but again his proposal comes close to ours.

Chairman ARCHER. Thank you very much.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

Mr. PRICE. Thank you.

Chairman ARCHER. Our next witness on behalf of the administration is the Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, who is accompanied by David Longanecker, who is Assistant Secretary for Postsecondary Education with the U.S. Department of Education.

Is Mr. Longanecker here?

Mr. LUBICK. He is here, Mr. Chairman, he will join me in replying to your questions. The statement of the Department of Education——

Chairman ARCHER. You do not prefer to have him seated next to you at the witness table?

Mr. LUBICK. Well, I will make my statement which, as you will see, is somewhat greater in breadth.

Chairman ARCHER. We are happy to have you back before the Committee, Mr. Lubick, and if you can summarize as much as possible with your oral testimony, your entire written statement will be included in the record, without objection. You may proceed.

STATEMENT OF DONALD C. LUBICK, ACTING ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY; ACCOMPANIED BY DAVID A. LONGANECKER, ASSISTANT SECRETARY, POSTSECONDARY EDUCATION, U.S. DEPARTMENT OF EDUCATION

Mr. LUBICK. Thank you, Mr. Chairman and Members of the Committee. I am happy to appear here before you again today, this time to discuss the tax provisions of the President's fiscal 1998 budget. The Committee has scheduled a series of three hearings on important components of the administration's tax plan and I would like to open this series with an overview of the tax plan and its major themes.

The first part of the budget package consists of a number of targeted tax incentives to promote high priorities of the administration: tax relief for hardworking, middle-income families to provide

for their families, educate their children and save for basic needs and economic relief for distressed areas and assistance to those coming off welfare to become independent, gainfully employed citizens.

Our gross tax cuts are $98.4 billion through fiscal year 2002. Everyone would like more tax reduction but the fiscally responsible course we have set on is the attainment of budget balance by 2002.

The budget offsets the cost of these tax cuts by making cuts in spending and by eliminating unwarranted corporate tax preferences, closing uneconomic tax loopholes and improving tax compliance. And these measures produce budget savings of $34.3 billion through fiscal year 2002.

Reinstatement of expired trust fund excise taxes and similar matters will produce additional savings of $36.2 billion through fiscal year 2002.

Others have proposed higher tax cuts but our commitment to balancing the budget and sound tax policy requires us to exercise restraint. As Secretary Rubin stated before this Committee on February 11, tax cuts that are much more costly than the President's proposals would require us to make cuts that are too deep in Medicare, Medicaid, education, the environment, or other priority areas.

Given the need for fiscal discipline, one of our principles is that tax relief should be concentrated on middle-income taxpayers. Consistent with that principle, over $90 billion of the $98.4 billion gross tax cut is attributable to four broad categories that comprise the President's Middle-Class Bill of Rights: education incentives, child credits, capital gains relief for housing, and savings incentives.

I will address education first. The budget contains tax incentives that you have already discussed to assist families with the costs of postsecondary education. We believe they will encourage Americans of every age to pursue their education beyond high school so that they can compete effectively in the global economy of the next century and achieve a higher standard of living.

These tax proposals complement other proposals in the budget to increase access to higher education such as the proposal to increase the maximum Pell grant by $300 and to make Pell grants more accessible to independent students with low levels of earnings.

The $1,500 Hope scholarship nonrefundable tuition credit and the $10,000 above the line education and job training tax deduction would help make 14 years of education the norm for all Americans. They would make a dramatic difference in family finances and are expected to help 12.3 million students in 1998 alone.

In fact, middle-income families would be able to combine the tuition deduction with the President's proposal to allow penalty-free IRA withdrawals for education or with a qualified State tuition program, in many cases avoiding all income tax upon college savings. We could discuss later some of the other additional education incentives.

Second, the child credit will provide families with young children a nonrefundable child credit, $300 in 1997, 1998, and 1999 and increasing to $500 thereafter for each dependent child under the age of 13.

We proposed capital gains tax relief by excluding up to $500,000 of gain for married taxpayers filing joint returns. This would simplify recordkeeping for over 60 million households who own their homes. The number of taxpayers paying capital gains taxes on residences would be reduced from about 150,000 per year to fewer than 10,000 per year, a quarter of a percent of those selling homes.

To encourage savings we have expanded the availability of IRA accounts to families with incomes up to $100,000, individuals up to $70,000. And the purposes for which withdrawals could be made without penalty tax would be broadened to include higher education costs, first home purchases and long-term employment.

There are other tax incentives that have been referred to, to support private-sector participation in revitalizing distressed communities, to generate job opportunities for long-term welfare recipients. They include current deductions for amounts paid to clean up blighted brownfields in distressed areas, new empowerment zones and enterprise communities and a new tax credit for equity investments in community development financial institutions.

To encourage the hiring of long-term welfare recipients in their transition from welfare to work we have proposed a new credit that we think will be extremely effective and Mr. Stark, I will be glad to discuss that in more detail during the question period.

We have extended for a year the research credit and other expiring tax provisions and are about to release as part of the budget some tax incentives designed to encourage hiring and increased investment in underdeveloped and underutilized areas in the District of Columbia.

I have mentioned the revenue offsets that are involved here and those too are intended to eliminate unwarranted tax gaming, to close uneconomic tax loopholes and to improve compliance.

Finally, Mr. Chairman, we continue to support revenue neutral initiatives designed to promote sensible and equitable administration of the tax laws, including simplification, compliance and taxpayer rights. And in the near future we propose to release to you a package of such measures for inclusion as part of our budget.

So, in conclusion, Mr. Chairman, this has been a rapid run-through of what is about that thick and you can see my briefing book is equally thick. I offered it to Mr. Rangel but he declined it. In conclusion, the President's 1998 budget will reach balance by 2002 with prudent tax reductions that are pro-family, pro-education, pro-economic growth.

The plan targets relief to those who need it the most while at the same time simplifying the tax system and halting abuses.

We look forward to working with the Committee on these proposals. I would be pleased to answer any questions you might have and I would like to ask Mr. Longanecker to accompany me because he is a specialist as Assistant Secretary of Education and I know you are concerned with some of the implications beyond the tax implications of these proposals. I thank you for your attention.

[The prepared statement follows:]

Statement of Donald C. Lubick, Acting Assistant Secretary for Tax Policy, U.S. Department of the Treasury

Mr. Chairman and Members of the Committee:

I am pleased to appear before you today to discuss the tax provisions of the President's Fiscal Year 1998 budget. The President's plan would provide targeted tax relief, promote a fairer tax system and encourage activities that contribute to economic growth, while achieving a balanced budget by Fiscal Year 2002. We look forward to working with all the Members of this Committee to accomplish these goals.

We are especially pleased that, following this overview of the tax provisions of the budget, the Committee is having this hearing today to focus on education issues. The President's FY 1998 budget plan contains a number of proposals to promote education. In particular, the President has offered several tax proposals to encourage higher education and job training. We welcome this opportunity to discuss these proposals with you.

In addition to encouraging investment in education, the President's tax plan would provide tax cuts to working families, capital gains tax relief and simplification targeted to home ownership, and tax incentives to promote savings and to promote the hiring of the economically disadvantaged. Under the President's plan, the gross tax cuts would total $98.4 billion through FY 2002.[1]

The President's tax plan is also fiscally responsible. The budget offsets the costs of these tax cuts by making cuts in spending and by eliminating unwarranted corporate tax subsidies, closing tax loopholes that are not economically sound, and improving tax compliance. These measures produce budget savings of $34.3 billion through FY 2002. Reinstatement of expired trust-fund excise taxes under the President's tax plan will produce additional savings of $36.2 billion through FY 2002.

Others have proposed higher tax cuts, but our commitment to balancing the budget and sound tax policy requires us to exercise restraint. As Secretary Rubin stated in testimony before this Committee on February 11, tax cuts that are much more costly than the President's proposals would require us to make cuts that are too deep in Medicare, Medicaid, education, the environment, or other priority areas.

Given the need for fiscal discipline, one of our principles throughout President Clinton's tenure has been that tax relief should be concentrated on middle-income taxpayers. In 1993, the Administration worked with Congress to cut taxes for 15 million working families by expanding the Earned Income Tax Credit (EITC), and to help small business by increasing expensing of capital investments and by providing targeted capital gains incentives. A year later, the President proposed his Middle Class Bill of Rights, including child tax credits, deductions for higher education, and expanded Individual Retirement Accounts. Then in 1996, he signed into law a number of other tax benefits for small businesses and their employees, as well as a new tax credit for adoption.

This year, the budget again proposes the President's Middle Class Bill of Rights, with a number of proposals aimed at helping middle-class families pay the bills, raise their children and send them to college, and save for retirement. This year, however, the plan goes farther. It includes more tax incentives and relief with regard to education and training, capital gains on home sales, work opportunities, and distressed areas, and provides employment and investment incentives to revitalize the District of Columbia.

MIDDLE CLASS BILL OF RIGHTS

The President's Middle Class Bill of Rights focuses on middle-income taxpayers. It includes targeted tax incentives to encourage investment in education and training. It would immediately and significantly benefit families with young children, and promote long-term saving. When evaluating the extent to which the Administration's budget enhances educational opportunities, however, these proposals must also be considered in conjunction with the President's Pell Grant proposals, which give comparable education incentives for those persons who do not have a high enough tax liability to benefit from a non-refundable tax credit.

Education and Training Incentives.

Well-educated workers are essential to an economy experiencing technological change and facing global competition. We believe that reducing the after-tax cost of

[1] The President's budget produces, without a sunset of the tax provisions, balance in FY 2002, under OMB assumptions. To ensure balance under CBO assumptions, the President's budget would sunset after FY 2000 the following tax provisions: the child credit; the HOPE scholarship tuition credit and tuition deduction; expanded IRAs (except in certain technical aspects); and the brownfields deduction.

education for individuals and families through tax credits and deductions would encourage investment in education and training while lowering tax burdens for middle-income taxpayers. There is widespread agreement that increasing the education levels of the U.S. work force is essential to a growing economy and an increasing U.S. standard of living. The ever-growing expenses of higher education, however, place a significant burden on many middle-class families.

The President's balanced budget plan contains tax incentives to assist families with the costs of postsecondary education. These incentives will encourage Americans of every age to pursue their education beyond high school so that they can compete effectively in the global economy of the next century and achieve a higher standard of living. Tax relief is provided to families of all kinds, whether they are saving to send a child to college, paying currently for a parent or child to attend college or graduate school, or hoping to lessen the burden of student loans. Tax benefits are available not only for undergraduate degree programs, but also for training to acquire or improve job skills. These tax proposals complement other proposals in the budget to increase access to higher education, such as the proposal to increase the maximum Pell Grant by $300 and to make more aid, including Pell Grants, more accessible to independent students with low income levels. In addition, the budget proposes to cut a variety of student loan fees.

The tax incentives are a key part of our agenda for higher education because they provide broad-based assistance, and they do not require more students to participate in the financial aid system. Also, by providing incentives to save for higher education, they can help families prepare for the cost of college, helping to reduce the demand for student aid.

The President's budget contains five specific tax proposals related to higher education. They are:

HOPE Scholarship Tax Credits. Taxpayers would be able to claim a nonrefundable tax credit of up to $1,500 per year (indexed for inflation beginning in 1998) for two years to cover tuition and fees for themselves, their spouses, or their dependents while enrolled at least half-time in the first two academic years of a degree or certificate program. To take the credit in the second year, the student must have attained the equivalent of at least a B minus grade point average in course work completed before that year. No credit is available if the student has been convicted of a drug-related felony. Federal grants (but not loans or work-study payments) reduce the allowable credit. The credit is phased out for families filing a joint return with modified AGI between $80,000 and $100,000 (between $50,000 and $70,000 for single filers), indexed for inflation beginning in 2001. The credit would apply to course work beginning after June 1997.

Education and Job Training Tax Deduction. As an alternative to the HOPE scholarship, taxpayers could elect to deduct up to $10,000 per year ($5,000 in 1997 and 1998) of tuition and fees for students enrolled at least half-time in a degree or certificate program, or for courses to improve job skills. The deduction can be claimed even by taxpayers who do not itemize. Unlike the HOPE Scholarship credit, which is calculated per-student, the deduction does not vary with the number of students in a family. The deduction is phased out at the same income levels as the HOPE Scholarship credit and would apply to course work beginning after June 1997.

These two provisions will help make 14 years of education the norm for all Americans. They would make a dramatic difference in family finances and are expected to help 12.3 million students in 1998 alone. In fact, middle-income families would be able to combine the tuition deduction with the President's proposal to allow penalty-free IRA withdrawals for education (or with a qualified state tuition program); in many cases, this would have the same effect as avoiding all income tax on college savings.

Tax-Free Employer-Provided Educational Assistance. We should also continue to encourage employers to provide educational assistance to their employees. Currently, up to $5,250 of tuition paid by an employer under a qualified educational assistance program need not be included in the income of the employee. However, the exclusion for undergraduate education expires in mid-1997, and the exclusion ceased to apply to graduate-level courses after mid-1996. The Administration strongly believes that the tax law should encourage employers that are willing to support employees' educations, including for those employees who have already graduated from college and who go back to school to develop new skills. The budget would reinstate the exclusion for graduate-level assistance retroactive to its prior

expiration, and would extend both undergraduate- and graduate-level assistance through December 31, 2000.

Ten Percent Tax Credit to Small Businesses that Provide Educational Assistance to Employees. In addition, the Administration believes that an additional incentive is needed to foster increased educational opportunities and work-force training for employees of small businesses that otherwise may be unable to devote sufficient resources to their employees' skill development.

To address this concern, the budget proposes that for taxable years beginning after December 31, 1997, and before January 1, 2001, small businesses (employers with average annual gross receipts of $10 million or less for the prior three years) would be allowed a 10 percent income tax credit for payments for education of employees under an employer-provided educational assistance program. This proposal will help offset administrative costs of small businesses providing educational opportunities for their employees. It is projected to benefit 1.7 million employees.

Expanded Tax-Free Treatment for Forgiveness of Student Loans. The Administration believes in encouraging Americans to use their education and training in community service. Providing tax relief in connection with the forgiveness of certain student loans will help make it possible for students with valuable professional skills to accept lower-paying jobs that serve the public. To this end, the budget eliminates the tax liability that normally arises when debt is forgiven, if the lender is a charitable or educational institution that lends money to a student to pay for education and then forgives the loan after the student fulfills a commitment to perform community or public service at low pay for a certain period of time. The same tax-free treatment would also apply when the Federal government forgives a loan made through the direct student loan program for a student who has been making income-contingent repayments for an extended period.

$500 Child Tax Credit.

Over the past decades inflation has reduced the value of the personal exemption, so the burden of taxes has shifted from smaller to larger families. A targeted child credit is an efficient way to address the increase in relative tax burdens faced by larger families. Under the Administration's budget plan, taxpayers would receive a $500 nonrefundable credit ($300 in 1997, 1998 and 1999) for each dependent child under the age of 13. The credit would be phased out for taxpayers with adjusted gross incomes (AGI) between $60,000 and $75,000. Beginning in 2001, both the amount of the credit and the phase-out range would be indexed for inflation.

The relief is directed to low- and middle-income taxpayers because of the limited resources available for tax reduction and higher-income taxpayers' relatively greater ability to pay current levels of income taxes. In the year 2000, this proposal will provide needed tax relief for over 17 million middle-income families. The credit would be nonrefundable, but working families would first deduct the child credit from their income taxes before deducting the refundable EITC—making it easier for them to get the benefit of both credits.

Expansion of Individual Retirement Accounts.

The Administration believes that individuals should be encouraged to save in order to provide for long-term needs, such as retirement and education. Tax policies targeted to middle-income taxpayers can provide an important incentive for generating new savings. (By contrast, new tax benefits for savings by upper-income people are more likely to result in shifting into tax-favored investments of savings that would otherwise occur.) The Administration's proposal would expand the availability of deductible individual retirement accounts (IRAs) to families with incomes under $100,000 and individuals with incomes under $70,000.[2] These thresholds, as well as the annual contribution limit of $2,000, would be indexed for inflation. As under current law, if an individual (and the individual's spouse) is not an active participant in an employer-sponsored plan, the individual (and spouse) would be eligible for a deductible IRA without regard to income.

Taxpayers would have the option of either deducting the amount deposited in an IRA account (and paying tax on the contributions and earnings when withdrawn), or forgoing an immediate deduction but not having to pay tax on either the con-

[2] Beginning in 1997, eligibility would be phased out for couples filing joint returns with AGIs between $70,000 and $90,000 ($45,000 and $65,000 for single filers). Beginning in 2000, eligibility would be phased out for couples filing joint returns with AGIs between $80,000 and $100,000 ($50,000 and $70,000 for single filers).

tributions or earnings on the contributions when the funds are withdrawn from a new Special IRA, provided the contributions remain in the Special IRA for at least five years. The purposes for which withdrawals could be made without early withdrawal tax would be broadened to include higher education costs, first-home purchases, and long-term unemployment.

Individuals with moderate incomes and younger people, who are now doing very little saving, should find the expansion of IRAs to meet a wider variety of savings needs, such as first-time home purchases and higher education expenditures, very attractive. This expansion also has a strong policy rationale. Homes frequently provide an important financial resource during retirement years, and education will improve productivity and economic security of the next generation. In addition, the knowledge that IRA assets are available to deal with possible family crises, such as unemployment, will make middle-income families more comfortable with beginning a commitment to IRA savings. Moreover, by dramatically increasing the number of middle-income taxpayers eligible for IRAs, financial institutions will have an increased incentive to advertise vigorously and to promote tax-preferred savings accounts. Widespread advertising and media attention to IRAs should be effective in increasing awareness of the importance of saving and encouraging IRA contributions, especially among moderate-income taxpayers.

Exclusion of Gains on Sale of Principal Residence.

The budget provides substantial simplification and tax relief for millions of Americans by replacing the current-law tax treatment of capital gains on home sales with an exclusion of up to $500,000 of gain for married taxpayers filing joint returns ($250,000 for other taxpayers). The exclusion is available every two years, so long as the taxpayer used the house as a principal residence for at least two of the five years prior to the sale (the exclusion would be pro-rated for taxpayers forced to move in less than two years). The exclusion generally applies to sales on or after January 1, 1997.

The budget proposal would provide substantial simplification. Currently, all homeowners must keep detailed records of the original cost and improvements to their home because of the potential for capital gains tax liability, even though fewer than four percent of home sales result in taxable capital gains. Under the budget proposal, record-keeping burdens for income tax purposes would be substantially reduced for over 60 million households that own their homes. The number of taxpayers paying capital gains tax on residences would be reduced from about 150,000 per year to fewer than 10,000 per year (one-quarter of one percent of those selling their homes).

Under current law, capital gains from the sale of principal residences are subject to tax. However, taxpayers can postpone the capital gains tax by reinvesting in a replacement residence with a purchase price equal to or higher than the adjusted sales price of the house that is being sold. In addition, taxpayers age 55 and over can elect to take a one-time exclusion of up to $125,000 in gains on residences.

The current-law postponement of capital gain from the sale of a principal residence encourages some taxpayers to purchase larger and more expensive houses than they need because the purchase price of a new home must be greater than the sales price of the old home. Current law also may discourage some taxpayers from selling their homes. When taxpayers feel they must move to a less expensive home, because they are experiencing financial difficulty, going through a divorce, or for other reasons, they currently must pay tax on any gain on their home sale. The budget proposal would eliminate these problems in almost all cases.

Similarly, while the one-time capital gains exclusion has successfully relieved most taxpayers over 55 from tax liability on the sale of their homes, it contains certain tax traps for the unwary that can result in loss of the benefits of the current exclusion and significant capital gains taxes. For example, an individual is not eligible for the $125,000 one-time capital gains exclusion if the exclusion was previously utilized by the individual's spouse. This restriction has the unintended effect of penalizing individuals who marry someone who has already taken the exclusion. The budget proposal would eliminate these traps for the unwary.

ESTATE TAX RELIEF FOR SMALL BUSINESSES AND FARMS

The budget proposes to ease the burden of estate taxes on farms and other small businesses, which may have a cash-flow problem when estate taxes must be paid after death. Under current law, estate tax attributable to certain closely held businesses may be paid in installments (interest only for four years, followed by up to ten annual installments of principal and interest). A special four-percent interest rate is provided for the tax deferred on the first $1 million of value. Only certain

types of business arrangements are eligible for the installment payment provision, and a special estate tax lien applies to property on which the tax is deferred during the installment payment period. To take full advantage of the available tax benefits, an estate must make an annual filing using complicated interrelated computations to recompute the payment due each year.

The budget proposal would address the liquidity problems of estates holding farms and closely held businesses, and simplify the tax laws, by increasing the value cap on the special low interest rate from $1 million to $2.5 million, expanding the availability of these rules to other comparable business arrangements, and authorizing the Secretary to accept security arrangements in lieu of the special estate tax lien. The applicable interest rates would be cut by 50 percent or more, but interest paid would be nondeductible, thus eliminating the necessity for annual filings and circular computations. These proposals generally would be effective for decedents dying after 1997, but estates already taking advantage of the installment payment plan would be given a one-time opportunity to convert to the lower nondeductible interest rate in order to simplify their filing requirements.

EMPOWERING COMMUNITIES AND THE ECONOMICALLY DISADVANTAGED

The budget contains proposals to spur private-sector participation in revitalizing distressed communities and to generate job opportunities for long-term welfare recipients.

Tax Incentives to Clean Up Blighted "Brownfields" in Distressed Areas.

To encourage companies to clean up abandoned, contaminated industrial properties located in distressed communities, clean-up costs associated with the abatement or control of certain pollutants would be immediately deductible if incurred for a qualified site. Qualified sites include business or income-producing properties located in specified high-poverty areas where it has been certified that hazardous substances are present or potentially present in the property. The deduction would be subject to recapture as ordinary income upon a subsequent disposition of the property at a gain. The proposal would apply to expenses incurred after the date of enactment.

This incentive is expected to leverage $10 billion in private investment to help bring an estimated 30,000 environmentally contaminated industrial sites back into productive use again, helping to rebuild neighborhoods, create jobs, and restore hope to our nation's cities and distressed rural areas.

Additional Empowerment Zones and Enterprise Communities.

The Empowerment Zone and Enterprise Community Program would be strengthened by a second round of designations and a new mix of federal tax incentives. The program rewards communities that develop comprehensive strategic plans for revitalizing their neighborhoods with a wide array of community partners. In the first round of designations announced in December 1994, 105 communities were selected.

Under the budget proposal, the Secretary of Housing and Urban Development would be authorized to designate two urban empowerment zones in addition to the six urban and three rural zones designated on December 21, 1994. This would have the effect of extending the current empowerment zone tax incentives to these additional areas, with technical modifications. In addition, 20 additional empowerment zones and 80 additional enterprise communities, which would be subject to modified eligibility criteria, would be authorized. Among the 20 zones, 15 would be in urban areas and five would be in rural areas. The 80 communities would be divided between 50 urban areas and 30 rural areas. Areas within Indian reservations would be eligible for designation.

These additional 20 zones would have available a different combination of tax incentives than those available to existing zones and would include the brownfields initiative, a current deduction for acquisitions of certain business assets, and an expanded form of tax-exempt financing. In addition, the investment incentives available in the original EZs and ECs would be strengthened.

Tax Credits for Community-Oriented Equity Investments.

Under the budget plan, access to capital in distressed communities would be enhanced through a new tax credit for equity investments in Community Development Financial Institutions (CDFIs). The Community Development Banking and Financial Institutions Act of 1994 created the Community Development Financial Institutions (CDFI) Fund to provide equity investments, grants, loans, and technical assistance to financial institutions that have community development as their primary mission.

The budget would make $100 million in nonrefundable tax credits available to the CDFI Fund to allocate among equity investors between 1997 and 2006. The allocation of credits is capped at 25 percent of the amount invested in any project and would be determined by the CDFI Fund using a competitive process. Over time, this incentive is estimated to result in at least $5 billion of new lending and investing in distressed urban and rural communities.

Tax Credits to Facilitate the Transition from Welfare to Work.

The goal of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 is to move individuals from welfare to work. However, it is anticipated that the process of moving some welfare recipients to work will be a difficult challenge for a variety of reasons, including a recipient's lack of prior work experience and skills relevant to the demands of a changing labor market. To encourage the hiring of these welfare recipients, the President proposes a new welfare-to-work credit that would enable employers to claim a 50-percent credit on the first $10,000 of annual wages paid to certain long-term family assistance recipients[3] for up to two years. Thus, the maximum credit would be $5,000 per year. The new tax credit would be effective through September 30, 2000.

In 1996, the Congress replaced the Targeted Jobs Tax Credit with a work opportunity tax credit (WOTC) of 35 percent of qualified wages paid to a targeted group during the first year of employment, up to a maximum credit of $2,100 per qualified employee. The WOTC expires after September 30, 1997. The President proposes to extend the WOTC for an additional year. Moreover, a new category of qualified employees would be added to the targeted groups. Under the President's proposal, the WOTC would be allowed to taxpayers who hire certain food stamp recipients (i.e., able-bodied adults age 18–50 who, under the Administration's Food Stamp proposal, would face a more rigorous work requirement in order to continue receiving Food Stamps). The credit for this group would be effective for individuals hired from the date of enactment through September 30, 2000.

OTHER TAX RELIEF PROVISIONS

Extension of Other Expiring Tax Provisions.

The budget would extend each of the following provisions for one year from their current expiration date:

- The 20-percent credit for research and experimentation expenditures (expiring May 31, 1997);
- The 50-percent credit for qualified clinical testing of certain drugs for rare diseases or conditions (known as "orphan drugs") (expiring May 31, 1997); and
- The fair-market-value deduction allowed for contributions of appreciated stock to private foundations (expiring May 31, 1997).

Equitable Tolling of the Statute of Limitations.

To ensure that disabled persons are treated fairly when filing for tax refunds, the statute of limitations for refunds from the Internal Revenue Service would be delayed when the individual is under a sufficient medically determined disability and no other person has been authorized to act on the taxpayer's behalf in financial matters. The proposal would be effective for taxable years ending after the date of enactment.

Tax Incentive for Economic Development of Puerto Rico.

To provide a more efficient and effective tax incentive for the economic development of Puerto Rico, the budget proposes to modify the Puerto Rican economic-activity credit—basically a wage credit—by extending it indefinitely, opening it to newly established business operations, and removing the income cap. The budget proposal will address a real need to preserve and create jobs for U.S. citizens in Puerto Rico.

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[3] "Long-term family assistance recipients" would be defined to include: (1) members of families that have received family assistance (AFDC or its successor program) for at least 18 consecutive months ending on the hiring date; (2) members of families that have received family assistance for a total of at least 18 months beginning on the date of enactment, provided that they are hired within two years of the date that the 18-month total is reached; and (3) members of families who are no longer eligible for family assistance because of Federal or state time limits, provided that they are hired within two years of the date that they became ineligible for family assistance.

Allow Foreign Sales Corporation Benefits for Computer Software Licenses.

The foreign sales corporation (FSC) provisions, which provide a limited exemption from U.S. tax for income arising in certain export transactions, currently are applicable to exports of films, tapes, records, and similar reproductions. Since computer software is similar to these other types of property, we believe that FSC benefits should be extended by legislation to licenses of computer software.

Tax Incentives for Economic Development of the District of Columbia.

The budget also includes a package of Federal income tax incentives designed to encourage hiring and increased investment in undeveloped and underutilized areas in the District of Columbia. We are still finalizing the details of this proposal and are discussing the economic development needs of the District with interested business and community leaders. Thus, the specific details of the incentives will be released shortly together with the other components of the President's plan to revitalize the District as the Nation's capital and to improve the prospects of success for home rule. To a large extent, the District tax incentives build on the Administration's Empowerment Zone and Enterprise Community incentives, the Work Opportunity Tax credit, and the President's proposed Welfare-to-Work incentive. Also included in the mix are substantial amounts of tax credits specifically designed to increase the availability of debt and equity capital for those projects in the District that are determined, at the local level, to promote increased economic activity most effectively.

The IRS will assume responsibility from the District of Columbia for administering the District's individual income taxes and unemployment insurance taxes, funded by an addition to the IRS appropriation for that purpose. As a condition of this change, specific authorizing legislation setting out the functions and timing will be required. The IRS will be responsible for management, tax return and refund processing, customer service, computer operations, compliance and enforcement, and will have all of its current enforcement powers available to it.

CLOSING CORPORATE TAX LOOPHOLES AND OTHER REVENUE MEASURES

The budget includes measures previously proposed by the Administration to eliminate unwarranted corporate tax subsidies, close tax loopholes that are not economically sound, and improve tax compliance. Such measures include:

- Proposals focused on financial products, to maintain the distinction between debt and equity, to curtail arbitrage opportunities, to prevent avoidance of gain recognition on functional sales, and to measure income properly;
- Proposals focused on corporate transactions, to prevent tax-free disguised sales of businesses, to prevent the manipulation of the stock redemption rules to distort income, to eliminate the use of inventory methods that mismeasure income, and to reduce corporate subsidies such as percentage depletion on lands received from the Federal government at a bargain price;
- Proposals focused on the international tax rules, to measure export income more accurately, to prevent manipulation of the foreign tax credit rules through artificial labels, and to eliminate distortions resulting from the use of derivative financial instruments; and
- Proposals focused on increasing tax compliance, for example by tightening the substantial understatement penalty for very large corporations, expanding withholding on gambling winnings, and streamlining debt collection procedures for nonmeans tested, recurring Federal payments.

Extension of Expired Excise and Other Trust Fund Taxes.

The budget also proposes reinstating the excise and other trust fund taxes that have expired: the Airport and Airways Trust Fund excise taxes;[4] the Hazardous Substance Superfund Trust Fund excise and income taxes; the Oil Spill Liability Trust Fund excise taxes; and the Leaking Underground Storage Tank Trust Fund excise tax. These are not new taxes: they have been applied for years to finance specific programs, such as the provision of air traffic control services and the cleanup of certain hazardous waste sites. Each of these taxes would be extended through 2007.

[4] The Administration will propose legislation to completely replace these taxes, effective October 1, 1998, with cost-based user fees, as part of the Administration's effort to create a more business-like Federal Aviation Administration.

TAX SIMPLIFICATION AND TAXPAYERS' RIGHTS

The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the tax laws, including simplification, technical corrections, compliance, and taxpayers' rights measures. In the near future, the Administration will propose to Congress a package of such measures.

CONCLUSION

In conclusion, the President's FY 1998 budget plan proposes to reach balance by 2002 with prudent tax reductions that are pro-family, pro-education, and pro-economic growth, and that are targeted to those who need them the most, with an emphasis on stopping abuses and simplifying the tax system. We look forward to working with the Committee on these proposals. I would be pleased to answer any questions that you might have.

Effect of Proposals on Receipts 1/
FY 1998 Budget

Proposal	03/04/97 05:01 PM	Fiscal Years 1998	2002	1998-2002 2/
			($'s in billions)	
Tax Cuts and Extension of Expiring Provisions				
Tax Cuts				
1 Augmented tax credit for children		-9.9	-10.4	-46.0
2 IRAs		-1.5	-1.7	-5.5
3 Incentive for education		-4.0	-9.4	-36.1
4 Three year extension of income exclusion for employer provided educational assistance (section 127) with 10% credit for small business (through 12/31/2000)		-0.6	0.0	-2.3
5 Capital gains exclusion on sale of principal residence		-0.3	-0.2	-1.4
6 Distressed areas initiative package		-0.4	-0.4	-2.3
7 CDFI		-0.0	-0.0	-0.0
8 Work opportunity tax credit (through 9/30/2000)		-0.1	-0.1	-0.6
9 Small business farm estate tax		-0.0	-0.2	-0.7
10 Equitable tolling		0.0	-0.0	-0.1
11 Extend Puerto Rico wage credit indefinitely		-0.0	-0.1	-0.4
12 Foreign Sales Corporation benefits for licenses of computer software for reproduction abroad		-0.1	-0.1	-0.6
13 D.C. tax incentive		-0.0	-0.1	-0.3
Extension of Expiring Provisions (1 yr.)				
14 R & E credit		-0.8	-0.0	-1.7
15 Orphan drug credit		-0.0	-0.0	-0.0
16 Contributions of appreciated stock to private foundations		-0.0	0.0	-0.1
17 Work opportunity tax credit		-0.1	-0.0	-0.4
Total Tax Cuts and Extension of Expiring Provisions		**-17.9**	**-22.8**	**-98.4**
Eliminate Unwarranted Benefits and Other Revenue Measures 2/		4.1	8.9	34.3
Other				
Excise Taxes		5.8	7.8	36.2
Non-Tax 2/		1.0	1.1	5.5
Total Other		**6.8**	**9.0**	**41.7**
Total Effect of Proposals on Receipts		**-7.0**	**-4.9**	**-22.4**

Department of the Treasury
Office of Tax Analysis

1/ Excludes outlay effects of $117 million in FY 2002 and $328 million for FY 1997 - FY 2002 and FY 1997 - 2007.
2/ Extension of Superfund corporate environmental income tax is included in Other/Non-Tax: $1.1 billion in 1998, $0.8 billion in 2002 and $4.2 billion in 1998 - 2002.

Chairman ARCHER. Mr. Lubick, thank you for summarizing what we realize is a complex and comprehensive proposal. I am sure the Members of the Committee will want to get in depth into some of the areas that maybe you have not been able to elucidate on in your testimony, and we are pleased to have Mr. Longanecker with us also.

I hope the Members of the Committee will attempt to concentrate on questions about your proposal that relate to education because we are going to have additional hearings that will get into other aspects of the tax proposal that you have made. That is not to preclude some ancillary connection between the education provisions and some other aspects of your tax proposal.

I would like to ask you a couple of very quick questions. I would like for you to confirm our analysis that the education tax credits expire at the end of the year 2000. Is that correct?

Mr. LUBICK. We do not believe that is correct, Mr. Chairman. The question is basically one of the assumptions as to whether or not the budget will be on track to reaching balance by fiscal year 2002.

The CBO has a different set of assumptions. They are much more conservative than ours. We believe ours are very conservative. For the last 4 years there has been a similar difference in assumptions. We have been wrong, the economy did better and, therefore, results were better than we had forecast.

The CBO was wronger and, therefore, we think it is prudent to continue along a path which has scored four for four. And, therefore we think that although for technical reasons because it is necessary to use the CBO assumptions, we have had to provide a sunset and a procedure for reinstatement if the budget objectives are on track we are firmly convinced that they will remain on track and that, therefore, it will not be necessary to sunset these particular provisions.

Chairman ARCHER. Well, Mr. Lubick, I understand the differences between the basic assumptions. That is really not what I am getting at. You submitted statutory language to us which sunsets these provisions at the end of the year 2000 and is specific, and there is no question about it, and it further requires an affirmative vote on the part of the Congress for extension. It is not automatic based on what the assumptions are, and every law that we have where there is a sunset statutorily and a requirement that there be an affirmative action on the part of the Congress is a sunset. That is statutory law, and that is what you submitted to us.

Now, this is not a question of differences between basic assumptions on what the economy is going to do. There is no guarantee that the Congress in the year 2001 or the year 2000 will affirmatively act to restore these education credits, is there?

Mr. LUBICK. Mr. Chairman, we believe that the sun will rise immediately following the sunset. It was necessary—we would have——

Chairman ARCHER. Now, I understand that, but what in your bill is going to mandate that the Congress take an affirmative vote and restore these tax cuts, assuming that your assumptions are correct?

Mr. LUBICK. We would be very pleased to submit a draft legislation that says that the continuation of these provisions is contingent on meeting the budget assumptions. But we understand that the CBO rules of scoring do not permit us to do that, so we have acquiesced in the only procedure of drafting that CBO would permit us to do. We think in essence it is going to lead to exactly the same result.

Chairman ARCHER. Mr. Lubick, the CBO will score anything you send up. They do not mandate the statutory language that you send up for their consideration. For you to tell this Committee that you sent up what the CBO told you you had to send up is just not a reflection of the way this process works. You made the election to send this language up. Now, I do not know what your motivation was, but I can tell you that the CBO does not mandate any statutory language. They will score whatever you send up. And you elected to send this up, for whatever reasons, in contrast to your

rhetoric in the presentation of your program when it was first unveiled.

Mr. LUBICK. Mr. Chairman, under our assumptions, clearly there will be no reason to trigger these provisions off. Now——

Chairman ARCHER. Mr. Lubick, please, let's stop talking in generalities about assumptions. The specificity of your statutory language that you sent to the Congress for enactment provides a sunset. And it further provides that if it is to be renewed, it requires an affirmative vote on the part of the Congress of the United States. It is not automatic. It is not dependent upon whether your assumptions are correct or not. So we have to deal with the statutory language that becomes the law of the land. And the reality is—and I do not know why you will not just admit it—that this sunsets and it will require an affirmative vote on the part of the Congress to reinstate it.

Mr. LUBICK. Well, Mr. Chairman, I believe that both the Joint Committee and the CBO have scored the provisions with and without the sunset, and it seems to me they are implicitly recognizing that if the targets are met, the tax cuts will stay on.

Now, if the Committee wishes to approve these provisions without the sunset, we would certainly endorse that because that is our objective.

Chairman ARCHER. Mr. Lubick, hypothetically, there can be a second estimate given to the Congress by the Joint Committee on Taxation and the CBO. Your statutory language is clear. It is unequivocal. And that is what you have sent up for us to implement. Why do you keep trying to duck this? What was your reason for sending that up if you want to try to duck it today before the Committee?

Mr. LUBICK. Mr. Chairman, I am not trying to duck it. The language also includes fast-track procedures for congressional re-enactment. That is the technical vehicle that is necessary to use to meet all of the requirements to attain the balanced budget by 2002.

Now, we will see in 2000 whether or not we are reaching our budget targets, and we firmly believe we shall.

Chairman ARCHER. No one today can know whether your basic assumptions are right or wrong.

Mr. LUBICK. That is correct.

Chairman ARCHER. You have sent up statutory language that sunsets these provisions at the end of the year 2000, and now you are trying to speculate as to whether something in the future is going to happen or is not going to happen. These provisions, statutorily, based on your language, are not an automatic extension, even under certain speculative circumstances. They have a clear statutory sunset. And I just would like for you just to say yes, that is true.

Now, I do not know why you did it that way, but just say yes, that is true.

Mr. LUBICK. Yes, that is true.

Chairman ARCHER. OK. Thank you very much. [Laughter.]

Mr. LUBICK. I am glad to accommodate.

Chairman ARCHER. I now recognize the gentleman from California for inquiry.

Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman.

Don, let me make about three—you might want to write them down, and with our limited time, I wanted to cover a couple of points. The first is if, in fact, there is a study or some kind of data to indicate that the tax credit will really create any new jobs. I am not being facetious, but I am just unaware of anything that—and if you do have it, it would help me because I am——

Mr. LUBICK. The studies that exist are of the old targeted jobs credit.

Mr. STARK. And they were not very—in a net sense, they did not do much.

Mr. LUBICK. And we believe that these particular credits that we are proposing, for a number of reasons which I will state, have a very good chance of being much more effective.

First of all, there has been a change in the low-wage labor markets. Welfare caseloads have fallen, and much more than would be expected from the performance of the economy. And in the new employment environment, we believe that the subsidies are much more likely to be helpful in getting—enabling people to get and keep jobs than they have in the past.

Mr. STARK. As I say, I am skeptical about the caseload changes so recently, and it is no secret that I did not vote for that welfare turkey. And so I am not sure that this is a way to fix a bad bill. But——

Mr. LUBICK. We have also——

Mr. STARK. I want to be—I want a chance to review your reasons, and I am very much in the minority here, so you can enlighten me otherwise.

I would like to go on to a couple of other areas.

Mr. LUBICK. We will send you a communication, Mr. Stark.

Mr. STARK. Because you know my prejudice, I want to now move over to what Mr. Gladieux will testify to later and see how you would respond to, I guess, what he and Bob Reischauer wrote and what the college board seems to think. And they do congratulate the President. They say we are fortunate to have an education President consistently and passionately stating that we need to invest more in education and training. Now, that is a pretty nice thing for you guys.

But—in the next paragraph—the President's proposed tax breaks for college tuition would not be an effective way to achieve these objectives. By and large, they benefit students and families in the upper-income quartiles where college enrollment rates are already very high and have been rising. Nine out of ten of the 18- to 24-year-olds from households in the top-income quartile enroll in some form of postsecondary education or training now, compared to a ratio of only one out of two of the lowest-income quartile whom you are not helping.

Now, I want to just ask you a couple questions. You have children?

Mr. LUBICK. Yes, sir. And they are all educated.

Mr. STARK. I sent some kids to college, but I now have an 18-year-old that I am about to send to college. I have two questions.

I know Secretary Rubin wants to increase savings and help our productivity. Why am I encouraged to save when you are going to

offer me this tax credit, assuming I retire by the time Fortney goes to college and so I am below the $100,000? I am not going to save now. Wouldn't the country be better off if we all put $100 a month or so away in savings? Question one.

Question two: When I qualify my son for this credit and I send you that Huggie, that soggy Huggie for you to test to make sure he is drug-free, who in the IRS is capable of analyzing this?

It is my sense that the IRS conducting your analysis in vetting out grade report cards is not going to be very happy with the added burden that you are going to place on them, and I know that the law says—and your able staff is going to tell you—they only have to not have—they have to be arrest-free. But that means you are going to have to go through all the criminal records in 50 States, and you are also going to have to audit the grades of these kinds. And I do not—I will bet you a nickel that the IRS, as they have in previous administrations, objects to this and that you are creating a nightmare. Who is going to do the urinalysis?

Mr. LUBICK. Let me say, Mr. Stark, I am sorry, but I think you will have to save anyway——

Mr. STARK. Yes, but not as much.

Mr. LUBICK [continuing]. Because this education credit phases out with incomes over $100,000. So——

Mr. STARK. But not as much. Let's say I drop below $100,000 when I retire. It is a somewhat disincentive to save. Right?

Mr. LUBICK. I don't think so, Mr. Stark. Having put three children through college, the credit would have been a help, but it would in no way have, when you consider the costs of education, begun to have solved the entire problem. I think by and large it is going to meet the needs of middle-income families that are having difficulty, combine that with the Pell grants that are going to help meet the needs of the lowest income taxpayers, and I think you have——

Mr. STARK. You are going to change those Pell grants to an entitlement?

Mr. LUBICK. Beg your pardon?

Mr. STARK. You are going to change those Pell grants to an entitlement? Do you know something I do not know about the Appropriations Committee?

Mr. LUBICK. I think that is a question I am going to throw to Mr. Longanecker, along with——

Mr. STARK. My time has expired, but I would like to have you quantify the number of new jobs you think will be created—new jobs—in whatever you send me. And I would also like—I would suspect that you have got some problems with the IRS and how they are going to deal with the added burden you place on them to verify these. Our past experience has been, as I know you know, that they do not like to get very far out of the normal income-expense area and that we may be wandering far afield.

Mr. LUBICK. I would like, Mr. Chairman, if we could have our reply to Mr. Stark inserted in the record as well.

Chairman ARCHER. Without objection.

Mr. LUBICK. I think we have answers to all of these questions.

Chairman ARCHER. Without objection, your reply in writing will be inserted in the record.

[The following was subsequently received:]

Effectiveness of Work Opportunity Tax Credit and Welfare-to-Work Incentives

Although many reports questioned the effectiveness of the prior targeted jobs tax credit, the criticisms of that credit may not be directly applicable to the work opportunity tax credit and the proposed welfare-to-work tax credit. Employment subsidies may now be much more helpful in enabling people to get and keep jobs than they have in the past. Welfare caseloads have fallen 18 percent in the last 2½ years, from 14.4 million in March 1994 to 11.8 million in October 1996. The reduction in caseloads is much greater than what would be expected from the performance of the economy. It is also not the direct result of legislation, since the first sanctions from the new welfare law will not take effect until late 1998. Those who are most able to work are likely to be the first to get jobs so the labor market barriers confronting those not currently working are likely to be more formidable. Targeted employment subsidies are more likely to be successful in these circumstances than when work was not a central focus of welfare reform efforts. The effectiveness of employment subsidies will be enhanced by the time limits established by the new welfare law.

In addition, the President has proposed a welfare-to-work challenge fund -- a three-year, $3 billion initiative that would provide flexible resources to help states and cities move one million welfare recipients into lasting jobs by the year 2000. This parallel effort will also increase the effectiveness of the work opportunity tax credit and the welfare-to-work tax credit.

Moreover, some of the criticisms of the targeted jobs tax credit are overstated. Work experience encouraged by the credit may have potential longer-run benefits that have not been measured adequately. Many of the skills acquired at work, such as showing up on time and dealing with customers and supervisors, are transferrable. Hence, working builds human capital that may result in longer-term future employment at a higher wage. Short-term evaluations of labor market interventions typically miss these longer-run effects.

There are several technical improvements in the work opportunity tax credit and the welfare-to-work tax credit relative to the targeted jobs tax credit. Under the targeted jobs tax credit, an individual was not treated as eligible unless the employer had received or requested certification from the designated local agency on or before the day work started. Because certification under the targeted jobs tax credit was typically made after the hiring decision, employers received payments for doing what they would have done in the absence of the credit. Under the work opportunity tax credit and the welfare-to-work tax credit, the employer

is required to pre-screen the employee for eligibility on or before the day employment is offered. These credits increase the incentive for employers to retain workers by raising the minimum employment period to 120 days or 400 hours (from the 90 days or 120 hours under the targeted jobs tax credit). The welfare-to-work tax credit also encourages employers to provide training, health and dependent care benefits that may improve the earnings and employment prospects of welfare recipients.

We do not yet have data from tax returns on the use of the new work opportunity tax credit. For the reasons discussed above, we believe that the work opportunity tax credit and the enhanced welfare-to-work tax credit will be more effective than the prior targeted jobs tax credit.

Eligibility Requirements for the HOPE Scholarship

Congressman Stark has also asked how certain eligibility requirements for the HOPE Scholarship would be met. Specifically, those requirements are that the student not have been convicted of any drug-related felonies before the end of any year for which the credit is claimed and that the student have at least a B minus cumulative grade point average at the beginning of the second year for which the credit is claimed.

With respect to the drug felony disqualification, the IRS will coordinate with the Department of Justice, which collects information on drug felony convictions. The IRS itself will not independently collect information showing whether a student has been convicted of a drug-related felony.

With respect to the B minus average requirement, the Secretary of the Treasury and the Secretary of Education will issue regulations to implement the credit. These regulations would require the educational institutions to file an information report for each student that would assist the student and the IRS in determining that the student meets the eligibility requirements for the credit and calculating the amount of the credit that is potentially available. Schools will not be asked to report the student's actual grades or grade point average, only to verify whether the student has met the B minus average requirement. The standards for evaluating whether a student has a B minus average will be established by the Department of Education, working with the higher-education community. These standards will accommodate institutions that do not use traditional grading systems.

—

Chairman ARCHER. Very quickly, do you provide for any additional appropriated funds to the IRS to carry out this additional duty?

Mr. LUBICK. Actually, Mr. Chairman, I do not believe——

Chairman ARCHER. Is that not subject to a yes or no answer?

Mr. LUBICK. Yes, that is subject to—no. We think it can be done within the existing——

Chairman ARCHER. All right. Thank you very much.

Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

Mr. Lubick, I have just one question, and it has to do with the $1,500 tuition credit. I have two of the most outstanding community colleges in the country in my district. One is the College of Lake County, and the other is Harper College. And they have done an outstanding job not only in giving kids an opportunity to work, stay at home, get at least 2 of their 4 years of a liberal arts education there, but they have also worked cooperatively to create special classes for training personnel with some of our major corporations in my district.

But their annual tuition rates are $800, and by contrast, the University of Illinois, if I am not mistaken, is approximately $15,000 a year. So there is a big financial incentive for a lot of these kids to get the 2 years off the table as they begin a working career.

My concern is that that $1,500 credit, it seems to me, is going to create a lot of pressure on those community colleges to take their tuition rates up to $1,500.

Mr. LUBICK. Well, Mr. Crane, I do not believe so. If I can recite a personal anecdote, when I got out of the Army at the end of World War II in 1946, I went to law school on the G.I. bill. Ninety-five percent of my classmates were in law school on the G.I. bill. The government was paying whatever tuition the institution charged, and during the whole period of my time in school, the tuition did not increase. It was exactly the same, and there you had no independent forces at work. Almost everybody at school with me was being totally subsidized as far as tuition is concerned.

We believe there are many, many independent restraints, and I will ask Mr. Longanecker to comment on that because he is an educational professional and well aware of them.

Mr. LONGANECKER. Yes, I think the natural laws of economics would argue what you have suggested, but there are other forces, including the laws of psychology and political science, that we think will be natural forces against that.

One is that as people hear about this, they are going to expect that benefit for themselves, and not expect that they will be disadvantaged or that the benefit will essentially go to the institutions or to the States.

A second is that even though this is a very substantial benefit, it still is targeted on a discrete set of students. So at those community colleges that you are talking about, this would be for those students who enroll greater than half time and, for the second year, maintaining a B-minus average in the first year.

As a result, most part-time students—and the majority of part-time students in community colleges today are enrolled less than half time—will have to pay the tuition, whatever that is. They will have the benefit of the deduction, but they will still be paying some of their tuition costs. So you will have the natural market forces still at work in that institution even though you will have a very substantial benefit for some students who, for all practical purposes, are going tuition-free to the community college. You will still have other natural forces constraining the costs, and you will have the political forces of the population not being really excited about increasing college costs.

Mr. LUBICK. In fact, Mr. Crane, I have here a study of the National Association of Independent Colleges and Universities, which predicts that the effect of this will be to reduce the pressures on tuition and go just the other way, because a portion of tuition today of the institutions is going to provide scholarships, and they will be relieved to some extent of that necessity.

Mr. CRANE [presiding]. Well, that is not the Chicago School of Economics, but I thank you for your presentation.

Mr. RANGEL. Mr. Chairman.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you.

Is there anyone in the White House that is going to monitor this bill and all the pieces that the various Committees have? Because, like Pete Stark, I think the worst part about the bill are the tax incentives which are skewed toward high-income people. But I can live with it. He cannot. I can live with it if it is part of a package that the President is assured has the support of the American people so that we all can believe that we are benefited—and not just the well-to-do.

Who would you think would be in charge of monitoring all of these pieces?

Mr. LUBICK. Well, we have an interagency and White House group that meets very frequently on that whole subject.

Mr. RANGEL. Let me join with my Chairman and ask that if you could come up with that person's name, it would be very helpful to me.

Mr. LONGANECKER. Actually, as we were mentioning, I think it is unusual that we are both here today and we are working very closely together. And you are absolutely right; this is a package. For us to have the benefits, you have got to have the pieces for the most needy students combined with the others. And the fellow who is in charge of that is William Clinton.

Mr. RANGEL. Who?

Mr. LONGANECKER. Bill Clinton.

Mr. RANGEL. Oh, don't give me a hard time. Don't do that. [Laughter.]

Mr. LONGANECKER. That is why he came up here to talk about it as a package. Actually, the person who is working for him and working most on this and is, I think, essentially the kingpin is Gene Sperling in the White House, the National Economic Council chief.

Mr. RANGEL. OK, because that is a big job.

Mr. LONGANECKER. Yes.

Mr. RANGEL. And I ask you, the second thing, is there are a lot of people in the private sector that want to participate in this? After all, we are improving the work market for them. They should have a couple cents to put in. They are spending tens of billions of dollars training and retraining their own. They are spending billions of dollars in taxes. And they should be partners in this.

Is the private sector working and having input in the President's proposal, to your knowledge?

Mr. LUBICK. Well, we certainly have been meeting with the educational community. I am sure that even more——

Mr. RANGEL. Is there anyone that is speaking out? Because once I see holes and vacuums, I have people to suggest to fill them. But I do not want to get ahead of the President because, as I said before you came here, I think this is one of the greatest things that we have. It is creating a climate that we should be creating. Now we will let Committees add and improve and do the best they can. But when this is over, our President should be able to say it is not just a Democratic bill.

Mr. LUBICK. I think there is neither a hole nor a vacuum, Mr. Rangel, but we would welcome your input and suggestions because there is always room on the ship for——

Mr. RANGEL. Well, I will talk with Gene Sperling. Gene has met with some of these people. I am glad to hear it was his name because he has met with the private sector. He is enthusiastic about this. The Chairman here and I are going to work to see whether we can have a team to work with this multijurisdictional problem. I thank Treasury for their part, even though I think it is the worst part of the bill. But if we can get a good, healthy bill that can get off the ground, that is more important than picking it apart.

Thank you.

Chairman ARCHER [presiding]. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman.

Mr. Lubick, in your written statement and in your oral testimony, you refer to Treasury Secretary Rubin's appearance before this Committee on February 11. I am not sure if you were here or had a chance to watch the rebroadcast of that, but we had a discussion about possible tuition inflation. And I inquired of the Secretary regarding the possible administrative costs and additional burdens to colleges and universities as a result of these requirements.

His response to me was, delivered only as the Secretary could, it will be the cost of a pencil.

Well, televised hearings are a wonderful thing because my office began to receive calls from registrars from colleges and universities across the country. Do you share the Secretary's belief that the proposals that you put in regarding these education incentives would be merely the cost of a pencil? Do you share the Secretary's view on that, sir?

Mr. LUBICK. I have not priced pencils lately, but I do share at least the implication that it will not be burdensome, because we have tried, working in conjunction with the Department of Education—this has been a marvelous exercise in interagency cooperation—but we are very sensitive to that and to not imposing requirements that are outside of the normal duties which the agencies

perform, which the institutions perform today in dealing with student aid and things like that.

We have designed an information form that we think requires only limited data which is already accessible to the institutions or can very easily be obtained. They are not going to be policemen. The IRS is not going to be a policeman. They are not going to run around reading blue books. We think the administrative aspects of this can easily be handled within existing procedures.

Mr. HULSHOF. Mr. Lubick, let me follow up, because schools currently calculate grade point average on a cumulative basis, not on a tax year basis. There are about a dozen colleges and universities in my district and some of them do not have advanced computer systems. Can you assure me that having to recalculate GPAs on a tax-year basis will not impose an additional cost or burden to those colleges and universities?

Mr. LUBICK. It is my understanding that they do that semester by semester, don't they?

Mr. HULSHOF. Some colleges and universities go quarterly. Some have trimesters. In fact, according to a survey conducted by the American Association of Collegiate Registrars and Admissions Officers, 81 percent of all institutions did not record grades received by other institutions.

So what happens if a student prefers to transfer midyear? If this transfer occurs, can you assure me and those registrars that there will not be any administrative burdens or additional costs associated by having to go back and recalculate this GPA? Can you assure me that burden will not be more than the cost of a pencil?

Mr. LUBICK. As far as I can tell—I will not contradict the Secretary on the cost of a pencil, but I can assure you that the burden will be minimal and within their capability of handling. And, Dave, if you——

Mr. LONGANECKER. Let me respond. We are doing everything we can to make sure that this is as simple to administer as possible. It may cost an expensive pencil for the institutions, but we are going to make sure that it is as de minimis an administrative burden as possible and still have integrity in the program. There may be some additional burdens to the institutions. I would not deny that. But we have a long history of working with those institutions in the student financial aid area. We assist more than 8 million students a year today through the variety of student financial assistance programs. So we have a long history of working with the community and believe that we can do this without substantial additional burden.

Mr. LUBICK. And the cost/benefit ratio to the institutions is going to be very, very heavily in their favor. The benefits they are going to receive from the program are going to outweigh any additional information 1099 form that has to be filed.

Chairman ARCHER. The gentleman's time has expired.

Mr. Coyne.

[No response.]

Chairman ARCHER. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. And welcome, Mr. Lubick. We appreciate your being here. Certainly some of the proposals that the administration has come out with are aimed at very

important problems, particularly in the affordability of education for middle-class families. And if there is any dispute here today, I think it has to do with the specifics of your proposals, not with your goals.

With regard to the specifics, I would like to focus on a couple of things. One, I notice that under your proposal, your credit would be available to students but restricted on the basis of grades and drug offenses, but not your deduction. Is there a reason for that distinction?

Mr. LUBICK. Yes, there is, Mr. English. The deduction is available by family, and we have not figured out, if you have got one drug user or one poor student and one clean student and one high student, how you average all of those things for a deduction.

Mr. ENGLISH. OK. I am curious. Will your required grade point average include things like summer programs?

Mr. LUBICK. Well, the grade point average is whatever the grade point average was through the end of the taxable year. We simplified this proposal considerably from the summer because we recognized there is a discongruence of the academic year and the tax year. So, in effect, somebody starting in September will go over three tax years, and we allow the credit in two.

Mr. ENGLISH. What about the fairly common situation where you have students who are collecting grades from courses taken at more than one institution in the academic year or tax year? Doesn't that dramatically increase the complexity of enforcing a grade point requirement for the credit?

Mr. LONGANECKER. It could, but the way we are going to do this is to try to keep it simple. If a school can demonstrate to us that the student was in attendance at their institution for that period of time, which is the end of the calendar year, and had those grades adequately to accomplish this, that will satisfy our purposes.

Mr. ENGLISH. OK.

Mr. LUBICK. We are not going behind the box. The IRS will accept the certification of the institution, and the rules for doing that will be the Department of Education's.

Mr. ENGLISH. Both institutions or all three institutions?

Mr. LUBICK. Pardon me?

Mr. ENGLISH. On one return, both institutions or——

Mr. LUBICK. No. You only need it basically from the one institution because the grade point average applies only to the second year of use of the credit, so it will turn on what the grade point average was at the end of the preceding year.

Mr. ENGLISH. OK. You know, when I went to college—and this is a stale experience—I envied some of my friends at Brown because at Brown in those days—and I think this may have been the result of a policy advocated by a graduate student named Ira Magaziner—a student was able to take all of their courses pass/fail. Now, what happens if you have an institution where four of the courses are taken pass/fail and the fifth course is cinema history and they got an A in it? I mean, does that person qualify in the same way that someone who is in an advanced physics program would qualify?

Mr. LONGANECKER. Yes. The answer is yes. If the institution verifies that that student has a better than C-plus average.

Mr. ENGLISH. OK. Let me jump to another thing because my time is running out. With regard to the drug enforcement provision, that to me suggests a very high level of complexity for a tax provision. What happens when you have different jurisdictions where you have ARD under first offense, you may not have access to those records? What happens to jurisdictions that allow closed records in the event of a drug offense? What happens to jurisdictions that open up the juvenile records? Are we talking only about adult offenses or juvenile offenses as well? And how do you reconcile the need to get records to document drug offenses—which, by the way, I am a strong opponent of drug offenses. I like the notion that you have included in your policy here, but I am curious how you could possibly enforce it, given those complexities.

Mr. LONGANECKER. Our intention is to enforce this similar to the way we do currently for Federal Pell grants and other student assistance where we have a similar requirement. What we do is we do a match with the FBI's data—or the Department of Justice's data system. It is a less than perfect system, but it is satisfactory.

Mr. ENGLISH. So, in other words—and I will leave you with this—they would have to have the offense recorded within the FBI recordkeeping in order for it to actually cause someone to lose access to the tax benefit.

Mr. LUBICK. Yes.

Mr. LONGANECKER. Yes.

Mr. ENGLISH. Thank you very much. I appreciate the opportunity to question you, and I thank you, Mr. Chairman, for your indulgence in that I have gone over my time.

Chairman ARCHER. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Lubick, let me begin by congratulating you and the administration on taking up an issue that is very important to millions of Americans. I find myself right now in that circumstance of this life of having a child in college and preparing three more for college. And if there is anybody on this Committee or if there is anybody in this room that thinks that the middle class is not struggling with the costs of college today, either they do not have their antenna up or they are not listening very carefully.

I would guess that there are many young staffers here seated behind some of our panelists today that have come out of college or graduate school carrying near-mortgage costs after parents have paid the national standard of 58 to 60 percent of those college costs. And while I support entirely, as one who spent a lot of my time in academe in a prior life, the notion of needs-based assistance, we are missing the grander point here of what has happened to college costs for the middle class across this country.

If Members of the Committee and others believe that it is easy for parents to reach for $25,000 to $30,000 per year for a child to go to college based upon an income of $100,000, they are making a terrible miscalculation. And we should simply poll members of the staffs that are here today and ask them about what they have experienced as they tried to meet the costs of paying back these college loans.

I am fortunate. I went to college with a national defense loan, 3 percent. Today the best you can do is about 9 percent. That is an extraordinary cost on top of $25,000 to $30,000 a year in college costs.

So I think that one of the most important elements in this debate is the letter that was sent to Chairman Archer from 268 high-tech companies requesting that we establish section 127 and make it permanent and also support this assistance for graduate education as well.

If the United States on the eve of the new century is to remain the only superpower on Earth, we have to demonstrate the same sort of commitment to education that we have offered to national defense. After all, real national defense means having children that can read and write and do basic calculations.

So I stand in support of the administration's effort here, if nothing else but to begin forcing the debate on what this has done. All you have to do is go to a small setting or an athletic event with high school children, and the issue of college costs dominates the conversation. And constantly we are asked, well, what are you folks doing about offering us some sort of assistance?

Now, specifically, why don't we talk for a second about your IRA proposal, and speak to those issues, if you can, for the Committee and how parents in the middle class could access some of these IRA moneys.

Mr. LUBICK. First let me say amen to your statement. And on the IRA question, it actually dovetails very nicely with the tuition deduction proposal. One can save up to $2,000 a year, deductible, in the IRA. It accumulates income. When it is time to pay the tuition for the child, a distribution is made without the IRA penalty. And while income is recognized, there is immediately a corresponding deduction that washes it out, so the effect is that you can save tax-free for education.

I think the combination of these two provisions is very helpful to the objectives that you are seeking.

Mr. NEAL. Both sides today, Mr. Lubick—and perhaps the other panelists might speak to the issue—have also zeroed in on an issue that is very timely, and that is, what colleges are doing to try to restrain some of the costs. I think there is some legitimacy to the criticism that as student aid has become more available and loans have become more plentiful, the truth is that college costs have been raised almost in a corresponding fashion. And I think that that has to be part of this debate. I am not suggesting here that there is much that the Congress is going to do about restraining college costs, but I do think that it ought to be part of the overall debate and discussion.

Mr. LUBICK. I think this is important enough that we will submit a letter dealing especially with that point, including this study that has recently been released.

[No information had been received at the time of printing.]

Mr. NEAL. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Ensign. Oh, I am sorry. Mr. Ensign, would you suspend for a moment?

Mr. Longanecker, you have a friend here on the Republican side of the Ways and Means Committee who would like to take just a few seconds.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. I am sorry, David, that I was late. I had another meeting. But I just wanted to formally welcome Dr. Longanecker to the Committee. We worked together for 10 years in the Minnesota Legislature, the Minnesota Senate, and I certainly appreciate your counsel through the years. Also, I am looking forward to hearing from another distinguished educator from Minnesota, Dr. McPherson, president of Macalester College, in the next panel.

So, welcome, David. It is especially good to see you here today, and I appreciate the outstanding job you are doing as Assistant Secretary.

Mr. LONGANECKER. Thanks a lot. I have a lot more Minnesota experience than Mike does. He just got there this last year.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Chairman ARCHER. Now, Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Mr. Longanecker, let me ask you a couple of philosophical questions from the administration's point of view. First of all, we have heard talk about K through 12 versus college. Where do you think the biggest problem in American education lies right now, in colleges or K through 12?

Mr. LONGANECKER. Well, we think that one has to be cognizant of the issues through the entire spectrum. If you take a look at——

Mr. ENSIGN. Right, but where would you say are the majority, the biggest problems?

Mr. LONGANECKER [continuing]. Look at President Clinton's Call to Action for American Education in the 21st Century. We have serious issues addressed in the Call to Action at all levels of education—preelementary, elementary, secondary, and postsecondary.

Mr. ENSIGN. OK. But just answer my question.

Mr. LONGANECKER. Well, I am the Assistant Secretary for Postsecondary Education, so I would logically tell you that the problems are in postsecondary education.

Mr. ENSIGN. If we look at how America is rated standards-wise, our university systems versus K through 12 with other industrialized countries, where are we rated better, with our university systems?

Mr. LONGANECKER. We are rated much better at the higher education end.

Mr. ENSIGN. Thank you. Having said that—and just because you are in education, I would imagine you at least have some expertise on K through 12—would you say that, on average, public schools or private schools offer—on average, now—a better education in America as far as test scores and by any measurable standard?

Mr. LONGANECKER. On average, controlling for all factors, there is relatively little difference, and the research is clear on that.

Mr. ENSIGN. Controlling for? In other words——

Mr. LONGANECKER. Controlling for the academic backgrounds of the students that they are serving.

Mr. ENSIGN. You are telling me that public schools offer the same——

Mr. LONGANECKER. Are just as good as private schools.

Mr. ENSIGN. Just as good. So in Chicago there is no difference between Catholic schools and public schools as far as number of students they send to college, number of students that they——

Mr. LONGANECKER. I am saying you control for the backgrounds of those students.

Mr. ENSIGN. I am talking about even for the backgrounds. There is no difference between those?

Mr. LONGANECKER. Yes, that is correct, on average nationwide.

Mr. ENSIGN. On average nationwide. Can you give me the documentation to back up what you are saying there?

Mr. LONGANECKER. Sure.

Mr. ENSIGN. Because that is certainly from everything else that I——

Mr. LONGANECKER. I will provide that.

Mr. ENSIGN. OK.

[No information had been received at the time of printing.]

Mr. ENSIGN. At the university level, is there a difference between private and public education, State-run versus——

Mr. LONGANECKER. One of the real differences—I think the difficulty you get in that comparison is that one of the things that really makes American higher education so distinctly different and, I think, much greater than the rest of the world is that we have a very diverse system of higher education, from the community colleges to the private liberal arts colleges, to the uniquely American research university. That is very different than almost any other country. So it is very difficult to say what is better.

What we have is a high-quality postsecondary education system that serves the unique needs of different learners quite differently, and I think does it well in a blended system.

Mr. ENSIGN. What percentage of the money, tax credit or whatever, is going to higher education in the President's budget versus K through 12?

Mr. LONGANECKER. A hundred percent would go to postsecondary education, not just higher education, that is, collegiate, but also to vocational and occupational-specific education and training. Much of it would go to students in——

Mr. ENSIGN. But not K through 12.

Mr. LONGANECKER. That is correct.

Mr. ENSIGN. So none of it is going to K through 12.

Mr. LONGANECKER. That is correct.

Mr. ENSIGN. When Senator Coverdell was here earlier, we were talking about if you do not have a foundation—that is the whole idea of Head Start, a proper foundation. Right?

Mr. LONGANECKER. Yes.

Mr. ENSIGN. The whole idea is to prepare them so they can come to K through 12 and at least be ready to learn. If they are not ready K through 12 to go to college, I mean, don't you think we have a little bit of this backward on where some of the money is going?

Mr. LONGANECKER. Well, we do not think so, and the reason is that you need to think of our total comprehensive package. We

have been very aggressive with respect to how we can increase the standards and have high achievement in our elementary and secondary schools through our regular appropriated programs. We think the tax system is a very appropriate vehicle for providing the unique kind of assistance that we are proposing to provide here, reducing the burden on those families going to college. We think the direct appropriated programs are much more appropriate for trying to increase the standards of elementary and secondary education and for helping the most needy students in postsecondary through the Pell grant program and through the student loan programs. So it is the overall package that we think hangs together.

Mr. ENSIGN. I would be very interested in the research that you have and who it is from on determining between private and public education, because we certainly had testimony here and, most of the information that I have at least been exposed to has shown that private schools, at least, in America K through 12 are giving a better education. That was one of the reasons for my line of questioning. If they are giving a better education, in other words, if your premise is right that they do not give a better education, well, OK. But if they do give a better education, why wouldn't we give scholarships to go to private schools. I think private schools give a good education. I think they give a distinct education, along the lines many of the private schools are there to provide, again that diversity we were talking about, an experience that families can choose.

Mr. LONGANECKER. But public education provides a good education as well. And I will provide you that.

[No information had been received at the time of printing.]

Mr. ENSIGN. If you had a choice——

Chairman ARCHER. The gentleman's time has expired.

Mr. ENSIGN. Just real quick?

Chairman ARCHER. Very quickly.

Mr. ENSIGN. If you had a choice between sending your kids in Washington, DC, to public school or private school, where would you send them?

Mr. LONGANECKER. My children, all three of them, have attended public schools from beginning to end.

Mr. ENSIGN. In Washington, DC.

Mr. LONGANECKER. I haven't lived in Washington, DC. If I lived in Washington, DC, I don't know what I would do.

Mr. ENSIGN. Thank you.

Chairman ARCHER. Mr. Levin.

Mr. LEVIN. Thank you. I had to be away for part of the questioning, and I think that you were asked about this issue of income distribution of the beneficiaries of the proposal, and you indicated that you were going to provide some information on that?

Mr. LUBICK. Well, Mr. Levin, we don't generally do distributions of individual text proposals. In this area, as David said, what we have here is a combination. You have the tax proposal, along with the Pell grant increase, and it is very, very difficult to—since you're not dealing with common denominators, there are asset tests as well as income tests in the direct programs.

But I think we can give enough general information to show that there is an equitable distribution for both low- and middle-income

persons. The Pell grants, quite obviously, are designed to fill the gap that a tax credit, which is nonrefundable, does not cover, and in point of fact, at one stage we considered a refundable tax credit, but the Pell grant approach seemed to be much more effective, much more efficient, much less complicating, fitted within existing programs.

And there is more money to some extent going into the Pell grant increase for the low-income persons than would have been the case under a refundable credit.

The income phase-outs that are provided for both the credit and the deduction make it clear that the benefits are distributed among middle-income taxpayers running from the lowest taxable taxpayers up till the phase-out takes place completely at $100,000.

And in addition to that, for the low-income persons, we have stacked the credit ahead of the earned income tax credit so the lowest income taxpayers that are eligible for earned income tax credit will not see any diminution of their otherwise available Hope scholarship credit.

Mr. LONGANECKER. If you look at these in combination, what you see is that at the very most needy level, the lowest income, the family starts with 3,000 dollars' worth of benefit in a Pell. That gradually reduces. It levels off at around $20,000–$25,000, to the $1,500 that they're getting either through Pell or through the tax credit.

And then it maintains that plateau until about the point where it starts to phase out at $80,000.

Mr. LEVIN. I do think you know this, that the more information you can supply, the better, because one of the attacks on the proposal is that it would mainly benefit high middle-income families.

Let me ask you quickly—I don't know if the Chairman heard Mr. Stark's opening statement. Mr. Chairman, I know you'd want me to give Mr. Lubick a chance, and his colleague, to, in 30 seconds, describe why you think 127 should once again apply to those who are in graduate programs.

Mr. LUBICK. Well, we think, as has been stated many times today, that the competitiveness of America turns upon skills, high skills, high technological skills, and it seems to me that depriving the benefit of this program for employers to train people in the most sophisticated information and skills is somewhat insane.

I think we would want to encourage that especially from the point of view of the ability of the country to perform economically in a competitive way.

Mr. LEVIN. Thank you.

Chairman ARCHER. Let me make an announcement, sort of a housekeeping announcement. The Chair hopes to conclude this session at 12 noon and return at 1 p.m. with the next panel. So I hope we can conclude the questioning for the administration's witnesses within the next 10 minutes.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman.

Good morning, and thank you for being here today. I'm a former math teacher at the middle school level in a very rural area where many of these programs are extremely important to some of our kids.

One of the things that I would like to ask, as you're listening to this discussion, and as we get into testimony and start to receive mail from our universities, our community colleges and our students, what kind of flexibility are we going to have in looking at some of these programs to meet the real needs that are out there?

Mr. LUBICK. I'm not sure——

Mrs. THURMAN. I guess I'm asking, is the administration willing to give us some flexibility? I know that some programs are very important, but I also think that potentially if there are some problems, or if there are some needs that we're not addressing, or that we're not meeting, and we've got this pocket of $40 billion, are we going to have the ability to have conversation, to really work and see where we might best benefit students in this country?

Mr. LUBICK. Well, I would say, having appeared before this Committee, starting in 1961, we have always found improvement in proposals which any administration has set up as it goes through the process.

So our minds are open, and our ears are attuned.

Mrs. THURMAN. With that, then, as you know, the next group of witnesses has written an editorial or a guest article. One of the questions they raise is if more than $40 billion is new, resources really can be found to expand access to higher education. Is this the best way to invest it? They go into the issue of need based.

Can you respond to that at this point? I know they are coming up next, but maybe give you a jump so we might ask them some questions.

Mr. LUBICK. Well, I think as Mr. Neal stated so eloquently, there is a real need in the middle-income group of the population that he alludes to.

Now, we quite agree, there is also a need to help those students who come from nontaxpaying families, and therefore we think we have been quite flexible in trying to both have our cake and eat it, too, and address a need that extends across a vast spectrum of the income distribution.

Mr. LONGANECKER. Our Pell and loan proposals are the most aggressive that have been proposed since the inception of the Pell grant program. So we're trying—and over the next 5 years, we'll put more into Pell than we'll put into the tax reduction plans. That's a $40-plus billion program over the next 5 years.

So it's not as though we're trying to back away from our appropriated programs. That is our primary responsibility. We do think, however, that our tax-based college financing approach fills a really important need as well.

I might also mention that we basically fundamentally disagree with Mr. Gladieux and Mr. Reischauer. We think this will change the ethic of participation in American higher education.

You know, middle-income families don't send their children to college at the same rate as upper-middle and wealthy families. And, so there is room for growth there. Plus those students don't persist in higher education at the rate that students from higher income families do.

So we think there is some room for improvement in both participation and completion, as there certainly is an unfinished agenda for the most needy students.

Mrs. THURMAN. OK. Let me ask another question very quickly, and this really goes to some issues that this Congress has dealt with with the welfare reform. I actually had a young woman in my district a couple of years ago call me.

She's on welfare, she has two children, and she's a single mother. She was eligible for a Pell grant. And she called me because she was very frustrated in the fact that the Pell grant dollars that she received bumped her up over the dollars level that made her or allowed her to be eligible for programs for her children, such as health care with Medicaid, and with some food stamps for her assistance.

And, quite frankly, she was very disturbed in the fact that here she was trying to work herself out of this, trying to put herself in a better position, and because of the Pell grant bumping her income up, it actually put her in a situation where she couldn't receive that because she put her children in jeopardy.

Mr. LONGANECKER. That's an issue we deal with fairly frequently. It varies substantially from State to State depending on what their welfare rules are, and how they count benefits. It's much less Federal requirements than it is State and local issues about how they distribute those funds.

To some extent, that's even a bigger problem today than it was 2 years ago.

Mrs. THURMAN. I think you're right, and I think somehow we need to address it. I'd just put that on the table, because I think as this Congress has worked so hard, and as many of our states have worked hard to move people from welfare to work, this is an opportunity. It's an educational opportunity that we ought not to be putting people in a position of not being able to accept what we're trying to do up here. Thank you.

Chairman ARCHER. I assume that all of the Members have had adequate time to inquire, and I appreciate your coming up, Mr. Secretary, and Mr. Longanecker. Thank you for your testimony.

I did not intend, by the way, Mr. Lubick, to be abrupt with you, but I was trying to move things along, because time was catching up with us. But we did conclude in time for lunch, so we made our schedule, and thank you very much.

Mr. LUBICK. It's always a pleasure to be with you, Mr. Chairman.

[The following questions were subsequently submitted by Mr. Thomas, to Treasury:]

1. Capital Gains

Why are capital gains on a residence so different from gains on stocks, farms or other assets that only housing gains should be exempt from taxes?

What is the number of taxpayers affected by this proposal?

2. Individual Retirement Accounts

How will the trigger mechanism that sunsets the President's provisions operate?

3. Education credits and tuition deduction

The President's budget explanation says each will be effective for "Payments made on or after January 1, 1997, for education commencing on or after July 1, 1997."

How does the Administration define the commencement of education?

—

[No answers had been received at the time of printing.]

Chairman ARCHER. The Committee will stand in recess until 1 p.m.

[Recess.]

Mr. RAMSTAD [presiding]. We're going to begin the afternoon hearing, pending the arrival of the Chairman and most of the Members who are still across the street voting.

But it's a privilege to welcome to the Committee our next panel. Lawrence Gladieux, who is the executive director for policy analysis for the College Board; Thomas Kane, assistant professor at the John F. Kennedy School of Government—Dr. Kane, good to welcome you here today—at Harvard; Dr. Michael McPherson, president, Macalester College in St. Paul—nice to see you, Mike—and Dr. Morton Schapiro, dean of the College of Letters, Arts and Sciences at the University of Southern California; and, not to slight a gentleman I just had an interesting conversation with, Dr. David Breneman, who is dean of the Curry School of Education at the University of Virginia.

Gentlemen, welcome, all of you, to the Ways and Means Committee, and I look forward to your testimony. I particularly want to welcome my friend, Mike McPherson, who is the distinguished president of Macalester College in Minnesota.

Our home State is well represented at today's hearing. This morning we heard from Dr. Longanecker from the Department of Education, and also I would note that there are a number of students here from Minnesota in our audience today, from the Minnesota State University Student Association, and the Minnesota Community College Student Association. It's good to see you here as well.

So we will begin our hearing here today. Dr. Gladieux, would you like to start?

STATEMENT OF LAWRENCE E. GLADIEUX, EXECUTIVE DIRECTOR FOR POLICY ANALYSIS, COLLEGE BOARD

Mr. GLADIEUX. Thank you, Mr. Chairman. My name is Lawrence Gladieux. I am director of policy analysis of the College Board, an association of 3,000 schools and colleges. Along with promoting high standards for all students, the College Board is a leader in the practice of need-based student financial assistance, aimed at equalizing access to postsecondary education.

The priority this administration has assigned to education is unprecedented, and the College Board applauds it. However, we have concerns about the President's tuition tax proposals, and these are reflected in a resolution by our Board of trustees that is attached to my written testimony.

The proposed tax breaks for college tuition would largely benefit students and families in the upper income quartiles, where college enrollment rates are already very high, and have been rising. The plan may be one way to cut taxes, but it is not an effective strategy for lifting the country's net investment in education or closing gaps in opportunity.

Most of the relief would go to those who are likely to find the resources and attend higher education regardless.

Since the tax credit under the President's plan is nonrefundable, students and families with no or minimal tax liability could not benefit, and under the administration's plan, eligibility for the tax credit would be offset dollar-for-dollar by the amount of Federal grant aid received by the student.

This would effectively exclude more than 3.5 million students below the median income who receive Pell grants. The median income in 1995 was about $40,000.

The last attachment to my written testimony is a set of bar graphs, and it shows on the top a graph of the administration's estimate of tax benefits for dependent students in the first or second year of college.

The biggest benefit is at $60,000 of family income, while the benefit is half as much for students at the $20,000 and $30,000 income levels, if they attend a 4-year private college, and zero or negligible if they attend a public or community college.

Keep in mind, again, the median income is roughly $40,000.

The administration has not released estimates for income levels higher than $60,000. But our own estimates—again I refer you to the last attachment, the bar graphs at the end of my testimony—suggest that the biggest benefits of all will be in the top income quartile—roughly $70,000 and higher.

The larger benefits kick in as the full value of the $10,000 deduction comes into play, especially for dependent students attending relatively high tuition colleges. In a nutshell, the higher the income, the more benefit; the lower the income, the less benefit.

Even if the tax credit were made refundable, thus helping some low-income students, in my view the timing reduces its practical value. A tuition bill paid in the fall might result in a year-end tax refund 4 or 6 months later. A second semester tuition payment in January might produce tax relief 12 to 14 months later. Some taxpayers might plan ahead and adjust their payroll withholding, but many couldn't afford to.

I also worry, as do others in the higher education community, about unintended consequences of the proposal, including regulatory entanglement with the IRS that was discussed this morning.

In the end I believe it would add multiple layers of complexity, not only to the Tax Code, but to the overall financing of students in higher education. But my biggest concern comes down to fairness and equity.

As proposed, the tuition tax breaks would establish by way of the Tax Code a major new entitlement for the middle and especially upper middle class, over time, I think, shifting resources away from the neediest students and families.

The administration has proposed a much needed $300 increase in the maximum Pell grant, but this does not balance the scales, compared to a $1,500 tax credit, or a $10,000 tax deduction. It only begins to restore the purchasing power of Pell grants that has been lost in the past 10 years or more.

The College Board applauds the Pell increase, and we will support it vigorously, but the overall plan remains imbalanced in our

view. Federal higher education policy has long promoted access, and this fundamental commitment should not be eroded.

If the country really can afford $30–$40 billion in new resources to make college more affordable, surely it would be better invested in proven grant, loan and work-study programs that do expand access.

Finally, I do support judicious use of the Tax Code to help students and families. I suggest the Committee consider these two points: First, we need to encourage more middle-income families to save well in advance of their children's education, and I support the piece of the President's plan that calls for savings incentives. Such incentives are also in Republican and Democratic bills in Congress.

Second, tax relief for student borrowers in repayment would also be constructive. Debt burdens are rising precipitously for many students. We support Republican and Democratic bills that are pending in the Congress that call for above-the-line deductibility of interest on student loans with benefits phased out at higher income levels.

Adjustments to the Tax Code along these lines would not be an expensive drain on the Treasury, or add great new complexity to the tax system, and they would complement, not compete with, existing need-based aid programs. So I hope the Committee will consider those kinds of proposals.

Thank you, Mr. Chairman, for this opportunity to address these important issues of tax policy and financing of higher education. I'll be glad to answer questions.

[The prepared statement follows:]

Statement of Lawrence E. Gladieux, Executive Director for Policy Analysis, College Board

My name is Lawrence Gladieux. I am executive director for policy analysis of the College Board, a national association of 3,000 schools and colleges dedicated to advancing equity and excellence for all students. Along with promoting high standards for all, the College Board since the 1950s has been a leader in developing the principles and practice of need-based student financial assistance aimed at equalizing access to postsecondary education.

Two attached documents place my testimony in context:

• The first is a resolution issued by the Trustees of the College Board last month that "commends the Clinton Administration for its substantial support of education; reaffirms the College Board's historic commitment to need-based student financial aid; and urges that proposals for tuition tax credits or deductions not be allowed to substitute or reduce funding for need-based aid." The resolution expresses concern that, with pressures to balance the federal budget, the government will not be able to "afford the estimated revenue loss from the tuition tax proposals while maintaining—let alone expanding—current appropriation levels for need-based student aid programs." Consistent with the Trustee resolution, a recent survey of College Board member institutions indicated strong support for restoring the value of Pell Grants and other increases in need-based student aid; they also support tax incentives, but not at the expense of need-based aid.

• The second is an op-ed piece that I co-authored last fall with Robert Reischauer, former director of the Congressional Budget Office. From the standpoint of both tax and education policy, we questioned the wisdom of investing $40 billion in scarce federal resources in the tuition credit/deduction plan.

As both the resolution and the op-ed piece began, I want to begin my testimony: The priority that this Administration has assigned to education is unprecedented and the College Board applauds it. We are fortunate to have an education president who has argued consistently and passionately that the country needs to invest more in education and training to boost economic growth, expand opportunity, and reduce growing income disparities.

But the President's proposed tax breaks for college tuition would not be an effective way to achieve these worthy objectives. By and large they would benefit students and families in the upper income quartiles, where college enrollment rates are already very high and have been rising. Nine out of ten 18–24 year-olds from households in the top income quartile enroll in some form of postsecondary education or training, compared to a ratio of one out of two from the lowest income quartile. The plan may be one way to cut taxes, but it is not an effective strategy for lifting the country's net investment in education or closing gaps in opportunity. Most of the relief would go to students and families who are likely to find the resources and attend higher education regardless.

College tuition levels have been rising faster than inflation for the past 15 years, so the burden of paying for higher education has increased for most families. But with widening income disparities in the 1980s and 1990s, it has increased the most for those on the bottom rungs of the economic ladder. College costs are taking a larger and larger bite out of the lowest family incomes.

The proposed tax breaks will not help those most in need. Since the current version of the tax credit is non-refundable (in an earlier version it would have been refundable), students and families with no or minimal tax liability could not benefit. And under the Administration's plan, eligibility for the tax credit would be offset dollar-for-dollar by the amount of federal grant aid received by the student. This offset provision would effectively exclude more than 3.5 million students below the median family income (almost $40,000 in 1995) who receive Pell Grants.

As part of its overall package for making college affordable, the Administration has proposed a much-needed $300 increase in the maximum Pell Grant, but this does not balance the scales compared to a $1,500 tax credit or a $10,000 deduction, and it only begins to restore the purchasing power of Pell Grants that has been lost in past two decades. Since 1979, the value of the maximum Pell has steadily dwindled relative to the cost of higher education, in 1995 covering less than 40 per cent of the average cost of attendance at a four-year public institution and only 15 percent of the average cost at a four-year private institution.

In addition to the offset for federal grants, tuition and fees as counted in the formulas would be reduced by the amount of non-federal grant aid. This would exclude or limit eligibility for the tax breaks in the case of many moderate-to middle-income students who receive various non-federal grant and scholarship assistance. State, institutional, and private grant programs extend assistance to students in the $30–60,000 range or higher. Thus many middle-income students who are the intended target of the Administration's proposal will not benefit.

I might add that even if the tax credit were to be made refundable, thus extending the benefit to some lower-income students, the timing of such a tax benefit reduces its practical value to families trying to make ends meet. A tuition bill paid in the fall might result in a year-end tax refund four or six months later; a second-semester tuition payment in January might produce tax relief 12–14 months later. Some taxpayers might plan ahead and adjust their payroll withholding, but most won't, and many can't afford to. The tax code, I suggest, is not an effective vehicle for helping people who are struggling to meet current tuition expenditures.

I also worry, as do many others in the higher education community, about unintended consequences of the President's proposal, including regulatory entanglement with the Internal Revenue Service. Involving the IRS in the delivery of such educational benefits, I believe, would be a mistake (IRS has consistently argued against such proposals through several administrations). It is not just the B-average and drug-free requirements (which are eligibility conditions for receipt of the tax credit though not the deduction). Colleges would more than likely be implicated in verifying tuition payments as well as receipt of federal and non-federal grant assistance which offset the tax benefits. In the end, I believe it would add multiple layers of complexity not only to the tax code but to the overall financing of students in higher education.

My overriding concern about the President's plan, however, comes down to issues of fundamental fairness, equity, and access. If the tuition tax breaks were to be enacted on anything like the scale proposed in the Administration's 1998 budget, they would establish by way of the tax code a major new entitlement for the middle- and especially upper-middle classes, with the potential of shifting federal resources over time away from the neediest students and families. The focus of federal higher education policy has long been to promote and equalize access, especially for those with the fewest resources, and this fundamental commitment should not be eroded. We applaud the Administration's proposed increase for Pell Grants—and the College Board will support it vigorously. But the overall package remains imbalanced.

If the country really can afford something approaching $30–40 billion in additional resources to expand access to higher education over the next five years, surely

it would be better invested in Pell and other grant, loan, and work-study programs. Existing aid programs are not just for the very poor. They help low- and, yes, middle-income students based on need, and they get the dollars to students when tuition bills are due, not months later in a tax refund.

WHO SPECIFICALLY WOULD BENEFIT FROM THE PROPOSED TUITION TAX RELIEF?

So far, the debate on the President's proposals has proceeded largely without data-based projections of the potential distribution of benefits. The Administration has said that the plan would broadly benefit middle-income Americans. I and others have suggested that the biggest benefits would go to the upper-middle class. In or out of the Administration, there is little analysis to inform the debate.

In the education community, we are hampered by the difficulty of assembling all the data (and tax modeling expertise) required to produce estimates of our own. The eligibility formulas are complicated. I am attaching descriptions and examples of the formulas for the proposed tax credit (up to $1,500) and deduction (up to $10,000). The taxpayer could choose between the two for the first two years of postsecondary education, after which the deduction alone would be available. To project the potential benefits, data or proxy data have to be assembled on at least the following: income distribution of students and dependency status; enrollment distribution by year in college and part-time/full-time status; tax filer information; tuition and fees paid by students/parents; and grants received, federal and non-federal. Many of the variables are interactive, complicating the modeling and analysis.

Last week the Administration released "illustrative examples" of who would receive the tax benefits among students at several different income levels if they attend an average-cost community college, four-year public institution, or four-year private institution. I have attached a graphic representation of the Administration's estimates of benefits for dependent students in the first or second year of postsecondary education. By far the largest benefits—the full value of the $1,500 tax credit—go to the student with a $60,000 family income, while the benefit is half that for students at the $20,000 and $30,000 income levels if they attend a four-year private college and negligible if they attend a public or community college. If the Administration were to release estimates for income levels higher than $60,000, I believe the data would show much larger benefits as the full value of the $10,000 tax deduction comes into play.

I should underscore that these projected benefits are for dependent students, those who are deemed to rely primarily on their parents or guardians for financial support. The Administration's estimates for independent students (now a majority of the postsecondary student population) show that the maximum tax credit of $1,500 would be received by students at the $20,000 and $30,000 levels, whichever type of institution they attend. The fact is, however, that one-third of independent students attending four-year institutions and one-fifth attending two-year public institutions have less than $10,000 in annual income, where the Administration's estimate shows zero benefits. Most of these students simply do not have sufficient income and thus tax liability to take advantage of the proposed credit.

Again, the Administration has not released estimates for higher-income levels, where the benefits are likely to be the greatest, especially for dependent students attending relatively high-tuition colleges and receiving the benefit of the tax deduction. To illustrate, I have attached a projection of the average tax benefits by family income at a private four-year college charging tuition of more than $20,000. The greatest average tax benefit, more than $2700, would be received by families in the $70,000–80,000 range. As the bar graph illustrates, even in the $80,000–100,000, income range where eligibility is phased out under the administration proposal, the benefits would still be greater than they would in the $50,000 range and below.

I have mentioned the inter-activity of the variables in the formula. Even when more definitive estimates can be developed, the fact is that such new tax benefits will interact with financial aid policies at the campus (and possibly state) level in ways that no model can predict. For example, institutions that award substantial amounts of need-based aid from their own funds are likely to take the tax benefits into account, either prospectively or retrospectively, when they evaluate family ability to pay. Thus many students and families that might receive the proposed tuition tax relief could see the benefit offset by reduced eligibility for campus-awarded student aid.

ALTERNATIVE, FOCUSED USES OF THE TAX CODE

Having summarized my concerns about the Administration's proposals, let me say that I support judicious use of the tax code to help students and families in financing the costs of postsecondary education. The College Board Trustee resolution rec-

ommends alternatives that would "boost college attendance, encourage families to save for college, and help relieve student debt burdens." Accordingly, I suggest the committee consider selective tax provisions focusing on the front and back ends of the college financing continuum, that is:

• College Savings. We need to encourage more middle-income families to save for their children's education. Currently, within certain income limits, the tax code excludes from income the interest earned on Series EE Savings bonds if the bonds are used to pay for higher education. Pending proposals, including the President's plan and Republican bills, call for additional incentives for the same purpose, either through expanded use of IRAs or new investment accounts dedicated to postsecondary financing. Increased incentives for savings would be helpful.

• Student debt burden relief. A measure of tax relief for student borrowers in repayment would also be constructive. Debt burdens are rising precipitously for many students. Several bills before Congress call for "above the line" deductibility of interest on student loans, with benefits phased out at higher income levels.

I also urge permanent extension of Section 127 exempting employer-provided tuition benefits, for both graduate and undergraduate training, from an employee's gross income. This has been an on-again, off-again provision in the tax code. Section 127 is a modest incentive for private sector investment in continuing education of adults. It supports lifelong learning. Studies show that beneficiaries earn close to the national average for full-time, year-round employees.

Modest, focused adjustments to the tax code along these lines would not be an expensive drain on the Treasury or add great new complexity to the tax system, and would complement, not compete with existing need-based aid programs. I hope the committee will consider them. (Among pending bills in the House that include one or more of the above proposals are H.R. 53, "Higher Education Accumulation Program Act," by Rep. Eshoo; H.R. 82, "Family Affordable College Tuition Act, by Rep. Schumer; H.R. 127, "Employee Education Assistance Act," by Rep. Levin; and H.R. 553, "Education Affordability Act," by Rep. Price. In the Senate, S. 1, "The Safe and Affordable Schools Act," the Republican leadership's proposal, also includes elements of the above, as does S.12, " Education for the 21st Century Act," the Democratic leadership's proposal.)

Thank you, Mr. Chairman, for this opportunity to address these important issues of tax policy and financing higher education. I shall be glad to answer the committee's questions.

The College Board
1233 20th Street, N.W., Suite 600, Washington, D.C. 20036-2304
Telephone: (202) 822-5900; Facsimile: (202) 822-5920

Washington Office

Tuition Tax Proposals and Student Aid

Board of Trustees of the College Board
January 26, 1997

Whereas in March 1996 the Board of Trustees adopted a resolution (see attached) that urged the Congress and Administration to maximize support for need-based student assistance--especially grants, with the objective of increasing aid to the neediest students;

Whereas the Clinton administration has given high priority to education and has proposed to extend opportunity to all Americans for at least two years of postsecondary education through tax credits for tuition payments, and lessen the financial burden of postsecondary education for many families through itemized tax deductions for tuition payments;

Whereas the Administration and Congress have both endorsed a balanced budget by 2002, thus making it improbable that the government can afford the estimated revenue loss from the tuition tax proposals while maintaining--let alone expanding--current appropriation levels for need-based student aid programs;

Therefore, be it resolved that the Board of Trustees of the College Board:

- commends the Clinton administration for its substantial support of education;
- reaffirms the College Board's historic commitment to need-based student financial aid; and
- urges that proposals for tuition tax credits or deductions not be allowed to substitute or reduce support for need-based aid.

Further, the Board of Trustees calls upon the College Board staff to:

- analyze and disseminate information on the potential distribution of benefits of tuition tax proposals;
- explore and advance changes to the tax code that would bolster college attendance, encourage families to save for college (e.g., education IRAs), and help relieve student debt burdens (e.g., restoration of student loan interest deductibility); and
- also support increased appropriations for Pell Grants and other need-based aid to restore the purchasing power that these programs have lost over the past fifteen years.

Board of Trustees - March 28-29, 1996

Support for Need-Based Student Aid

Whereas the College Board champions educational excellence for all students through the ongoing collaboration of member schools, colleges, universities, educational systems, and organizations; and;

Whereas the Board of Trustees has established an equity agenda for the College Board with the goal that, by the end of the twentieth century, individuals from traditionally underrepresented groups have access to and complete postsecondary education at the same rate as traditional students; and

Whereas wide disparities in educational attainment persist in the US, and a young person from a family in the top income quartile is ten times more likely to have received a college degree by age 24 than another person whose family income falls in the bottom quartile; and

Whereas need-based financial assistance is critical as a factor in equalizing college opportunities and in providing an incentive for low-income families to prepare for postsecondary education; and

Whereas there is evidence that grant aid is more effective than loan assistance in boosting participation rates as well as helping low-income students stay in college and complete their degrees; and

Whereas today most federal aid is in the form of loans (75 percent) rather than grants (25 percent), compared to the reverse 20 years ago (75 percent grants, 25 percent loans); and

Whereas proposals for academic merit-based federal scholarships should not be allowed to substitute or reduce support for need-based student financial aid; and

Whereas need-based postsecondary financial aid is a vital investment in the our future economic security and competitiveness;

Therefore be it resolved:

That the College Board urge Congress and the Administration to maximize support for need-based student assistance, especially grant aid, throughout the FY 1997 federal budget deliberations, in the 1997-1998 reauthorization of the Higher Education Act, and beyond, with the objective of increasing the amount of aid available to the neediest students.

The College Board

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Vice President for Enrollment
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Greenville, South Carolina

The Washington Post
September 4, 1996

HIGHER TUITION, MORE GRADE INFLATION

Lawrence E. Gladieux
and
Robert D. Reischauer

More than any president since Lyndon Johnson, Bill Clinton has linked his presidency to strengthening and broadening American education. The President has argued persuasively that the nation needs to increase its investment in education to spur economic growth, expand opportunity and reduce growing income disparities. He has certainly earned the right to try to make education work for him as an issue in his reelection campaign, and that's clearly what he plans to do.

Unfortunately, one way the President has chosen to pursue his goals for education is by competing with the GOP on tax cuts. The centerpiece of his education agenda--tax breaks for families paying college tuition--would be bad tax policy and worse education policy. While tuition tax relief may be wildly popular with voters and leave Republicans speechless, it won't achieve the President's worthy objectives for education, won't help those most in need, and will create more problems than it solves.

Under the President's plan families could choose to deduct up to $10,000 in tuition from their taxable income or take a tax credit (a direct offset against federal income tax) of $1500 for the first year of undergraduate education or training. The credit would be available for a second year if the student maintains a B average. The vast majority of taxpayers who incur tuition expenses--joint filers with incomes up to $100,000 and single filers up to $70,000--would be eligible for these tax breaks. But before the nation invests the $43 billion that the administration says this plan will cost over the next six years, the public should demand that policy makers answer these questions:

Will tuition tax credits and deductions boost postsecondary enrollment? Not significantly. Most of the benefits would go to families of students who would have attended college anyway. For them, it will be a windfall. That won't lift the country's net investment in education or widen opportunities for higher education. For families who don't have quite enough to send their child to college, the tax relief may come too late to make a difference. While those families could adjust their payroll withholding, most won't. Thus any relief would be realized in year-end tax refunds, long after families needed the money to pay the tuition.

Will they help moderate- and low-income students who have the most difficulty meeting tuition costs? A tax deduction would be of no use to those without taxable income. On the other hand, the proposed $1500 tax credit--because it would be "refundable"--would benefit students and families even if they owe no taxes. But nearly four million low-income students would be largely excluded from the tax credit because they now receive Pell Grants which, under the Clinton plan, would be subtracted from their tax credit eligibility.

Will the plan lead to greater federal intrusion into higher education? The Internal Revenue Service would have to certify the amount of tuition students actually paid, the size of their Pell Grants, and whether they maintained B averages. This could impose complex regulatory burdens on universities and further complicate the tax code. It's no wonder the Treasury Department has long resisted proposals for tuition tax breaks.

Will the program encourage still higher tuition levels and more grade inflation? While the tuition spiral may be moderating slightly, college price increases have averaged more than twice the rate of inflation during the 1990s. With the vast majority of students receiving tax relief, colleges might have less incentive to hold down their tuition increases. Grades, which have been rising almost as rapidly as tuition, might get an extra boost too if professors hesitate to deny their students the B needed to renew the tax credit.

If more than $40 billion in new resources can really be found to expand access to higher education, is this the best way to invest it? A far better alternative to tuition tax schemes is need-based student financial aid. The existing aid programs, imperfect as they may be, are a much more effective way to equalize educational opportunity and increase enrollment rates. Over $40 billion could go a long way to restoring the purchasing power of Pell Grants and other proven programs whose benefits inflation has eroded by as much as 50 percent during the past 15 years. Unlike tuition tax cuts, expanded need-based aid would not drag the IRS into the process of delivering educational benefits. Need-based aid also is less likely to increase inflationary pressure on college prices because such aid goes to only a portion of the college-going population.

Economists have long argued that the tax code shouldn't be used if the same objective could be met through a direct-expenditure program. Tax incentives for college savings might make sense; parents seem to need more encouragement to put money away for their children's education. But tax relief for current tuition expenditures fails the test.

Maybe Clinton's tuition tax relief plan, like the Republican across-the-board tax-cut proposals, can be chalked up to election-year pandering that will be forgotten after November. But some campaign themes, repeated often enough, make it into the policy stream. That was the case in 1992 when candidate Clinton dwelled on a couple of ideas that, as president, he has since turned into constructive initiatives: student loan reform and community service. If re-elected, President Clinton again may stick with his campaign mantra. This time, it's tuition tax breaks. This time, he shouldn't.

Lawrence E. Gladieux is executive director for policy analysis of the College Board. Robert D. Reischauer is senior fellow in economic studies at the Brookings Institution and former director of the Congressional Budget Office.

Formula for Calculating the "Hope Scholarship" Tax Credit

$$\text{CREDIT} = \left(\begin{array}{c} \textit{The Lesser of} \\ \text{Tuition + Fees} - \text{Non-Federal Grants} \\ \textit{- or -} \\ \$1{,}500 \end{array} \right) - \text{Federal Grants}$$

Example A
Tuition + Fees = $2,000
Non-Federal Grants = $1,000
Federal Grants = $750

Step 1: Subtract non-federal grants from tuition and fees:

(2,000 – 1,000) = 1,000

Because this amount is less than $1,500, it is used in the calculation.

Step 2: Subtract federal grant total from previous sum:

1,000 – 750 = 250

The taxpayer would be entitled to a $250 tax credit.

Example B
Tuition + Fees = $5,500
Non-Federal Grants = $1,000
Federal Grants = $750

Step 1: Subtract non-federal grants from tuition and fees:

(5,500 – 1,000) = 4,500

Because this amount is more than $1,500, the maximum credit of $1,500 must be used in the calculation.

Step 2: Subtract federal grant total from previous sum:

1,500 – 750 = 750

The taxpayer would be entitled to a $750 tax credit.

Formula for Calculating the Clinton Tuition Tax Deduction

DEDUCTION = (Tuition + Fees – All Grants) OR $10,000 ***(whichever is lower)***

Example A
Tuition + Fees = $7,500
Non-Federal Grants = $1,000
Federal Grants = $750

Calculation: Subtract the total grant amount from tuition and fees:
(7,500 – (1,000 + 750)) = $5,750

Because the total is lower than the $10,000 maximum deduction, the taxpayer would be entitled to a deduction of $5,750.

Example B
Tuition + Fees = $18,000
Non-Federal Grants = $3,000
Federal Grants = $0

Calculation: Subtract the total grant amount from tuition and fees:
(18,000 – (3,000) = $15,000

Because the total is larger than the deduction limit, the taxpayer would be entitled to a maximum deduction of $10,000.

The College Board
Educational Excellence for All Students

Figure 1. Projected Average Tax Benefit for First and Second Year Dependent Students Based on the Administration's Proposal, by Institution Type and Selected Family Income Levels (Data Source: U.S. Department of Education, February 1997)

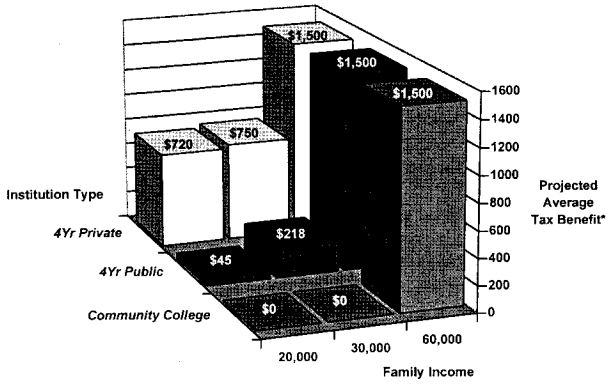
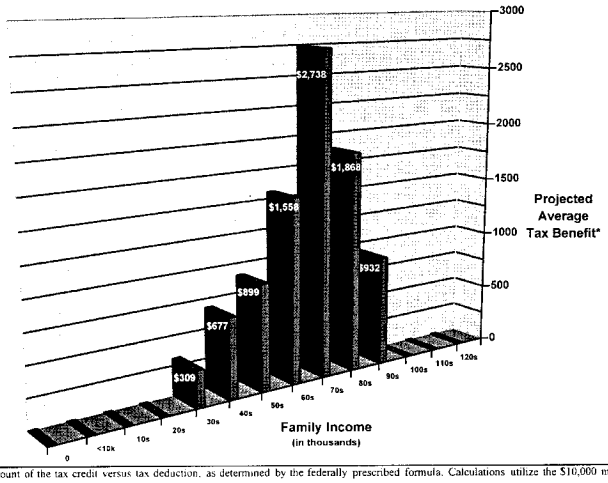


Figure 2. Projected Average Tax Benefit for an Incoming Dependent Freshman student at an Independent Private Four-Year College Based on the Administration's Proposal, by Family Income**



*Tax benefit = the greater amount of the tax credit versus tax deduction, as determined by the federally prescribed formula. Calculations utilize the $10,000 maximum tax deduction, scheduled to phase in by 1999.

**Calculations were based on 1997-98 income and tax data from a four-year private college with an annual tuition rate of approximately $21,000. Figures were derived from the institution's undergraduate incoming freshman student aid applicant database, as well as institutional data on federal and non-federal grants received.

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Background Information re: College Attendance and Costs

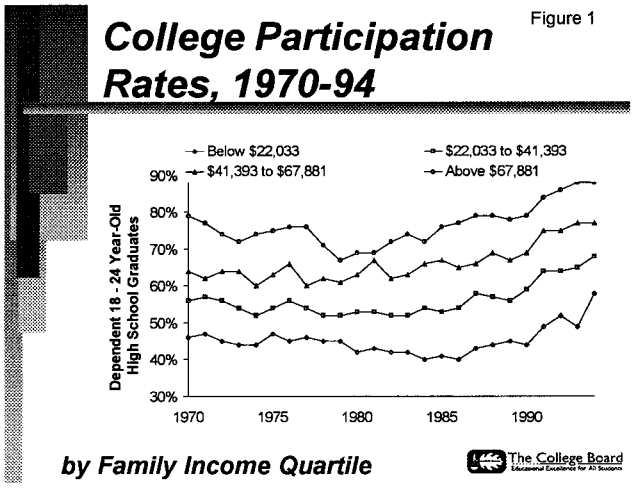
Approximately 48% of American adults (age 25 and older) have participated in some postsecondary education, and 23% of adults have a 4-year (bachelors) degree or more.

The chart below is a snapshot of the current undergraduate enrollment distribution and average tuition costs by type of institution.

Type of Institution	% of Undergraduate Population	Average Tuition and Fees (1995-96)
2-Year Public	45%	$ 1,300
4-Year Public	30%	$ 3,000
4-Year Private	16%	$12,800

Note: 8% of students attend private, for-profit institutions.

The chart below represents historical college participation rates by family income quartile.



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Mr. RAMSTAD. Thank you—Mr. or Dr. Gladieux.
Mr. GLADIEUX. Mister.
Mr. RAMSTAD. I don't want to handout Ph.D.s gratuitously here.

Mr. GLADIEUX. I sometimes get honorary doctorates that way, but this time you have it right.

Mr. RAMSTAD. Thank you for your testimony. Mr. Kane.

STATEMENT OF THOMAS J. KANE, ASSISTANT PROFESSOR, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY, CAMBRIDGE, MASSACHUSETTS

Mr. KANE. Thank you, Mr. Chairman, and other Members of the Committee for giving me the opportunity to speak today. I just wanted to make clear at the beginning that I'm not representing Harvard University or the Brookings Institution or any other place I've ever worked before. I am just here as a taxpayer and as an economist who has studied higher education issues for a few years now.

I want to make three specific comments about the administration's proposal, and then close with just one general observation about the crisis in higher education. First, regarding targeting. Given what's been going on in the labor market, college enrollment rates have been rising. The proportion of 18- to 24-year-olds enrolled in college, today, is about 33 percent higher than it was in 1980. But its been mostly middle and higher income families who have been responding to the changes in the labor market. To the extent that there is a problem, it's been the low-income students who have been lagging.

If you look at the administration's proposal, there is $300 in it for the lowest income Pell grant recipients in the form of increased grants. On the other hand there's a $2,800 tax benefit for somebody in the 28-percent tax bracket who is attending an expensive private institution. Those benefits are a little bit lopsided, and I think, as several people have mentioned, moving more of the benefit into the Pell grant program would be a step in the right direction.

Second, I wanted to mention two administrative concerns. One issue that wasn't mentioned this morning is the potential for abuse of the tax credit for leisure-oriented course work, which I fear, is potentially the most costly administrative concern at issue. There is language in the proposal to limit the credit to people who are half-time students in degree-granting programs. However, once there's $1,500 on the table, taxpayers and colleges are likely to show great ingenuity in figuring out how to qualify virtually any course for the credit, even courses on whale-watching or Oriental rug-buying, which presumably are not the intent of the legislation. That's going to be a problem down the road, and we've not talked about that very much.

The second administrative concern was discussed this morning: the B-average requirement. Now, I agree with David Longanecker and Mr. Lubick that the administrative problems are not insurmountable. But we ought to be asking ourselves not just whether we could administer a B-average requirement, but whether the benefits of the proposal justify the costs.

Let's take a step back and ask "Why are we doing this?" Well, presumably the whole point of the B-average requirement is to encourage people to work harder during their first year in college. But the requirement could have exactly the opposite effect. For instance, any risk-adverse student would take easier courses during

their first year to try to make sure that they got the B-average, or, as other people have mentioned, there's the possibility of grade inflation. I oppose the B-average requirement not because it's administratively impossible, indeed the administrative obstacles don't seem insurmountable, but because I just don't see the benefits of the proposal exceeding the costs imposed on colleges and the IRS. And I think the administrative costs would be nonnegligible.

Third, I want to say something about the potential for tuition inflation. I may be an optimist, but contrary to the fears of some of the plan's critics and, perhaps, contrary to the secret hopes of many college presidents out there, I don't think that this proposal will lead to much tuition inflation. The reason is simple: even the families who are getting tax relief, won't be getting any additional tax relief when their college raises tuition. So if I am the president of Kalamazoo College, I might like to raise my tuition, but I might lose some students to Macalester College if I did. To the extent that there is competitive pressure out there, I think that tuition inflation will be negligible.

Finally, I just wanted to make a comment, just generally, about our student financial aid system. And that is that simplicity and transparency should be fundamental policy objectives here. The fact is we already have a number of grant and loan programs to help families pay for college. However, the system is so complicated that you have to have a college degree in order to understand it. The President's message resonated, I think, because many families out there are honestly worried about how they're going to pay for college, and are a little baffled about the range of programs that we have available. I think we could go a long way to relieving families' anxiety about paying for college by simplifying and consolidating the programs that we already have, and need not end up spending a lot more money in the process.

Thank you, Mr. Chairman, for giving me the opportunity to testify today, and I look forward to questions at the end.

[The prepared statement follows:]

Statement of Thomas J. Kane, Assistant Professor, Kennedy School of Government, Harvard University, Cambridge, Massachusetts

INTRODUCTION

In his 1997 State of the Union address, President Clinton declared educational reform the top priority of his second term. Indeed, the Administration's agenda for higher education is unabashedly ambitious, to "...make the 13th and 14th years of education—at least two years of college—just as universal in America by the 21st century as a high school education is today." [1] To fulfill that promise, the Administration has proposed two major initiatives for higher education: an increase in federal grants to low-income undergraduates and various forms of tax relief for those with family members in college. Beyond evaluating the narrow strengths and weaknesses of the Administration's proposal, the goal of this testimony is to assess how well the proposal meets the long-term challenges in financing higher education.

Declining labor market prospects for those without college training have led more families to seek out a college education for their children. Yet such investments are costly to parents, students and other taxpayers, amounting to roughly $12,000 per year at a public 4-year university and $6,000 per year at a community college—not counting the earnings foregone by students in college. The challenge over the next decade will be to find a way to pay for college that does not discourage family earnings or savings, which encourages students to make the most of the value of the resources at their disposal, and which allows students from all family backgrounds to make worthwhile investments in college. The Administration's proposal will offer some short-term relief to families concerned about rising tuition bills. However, in

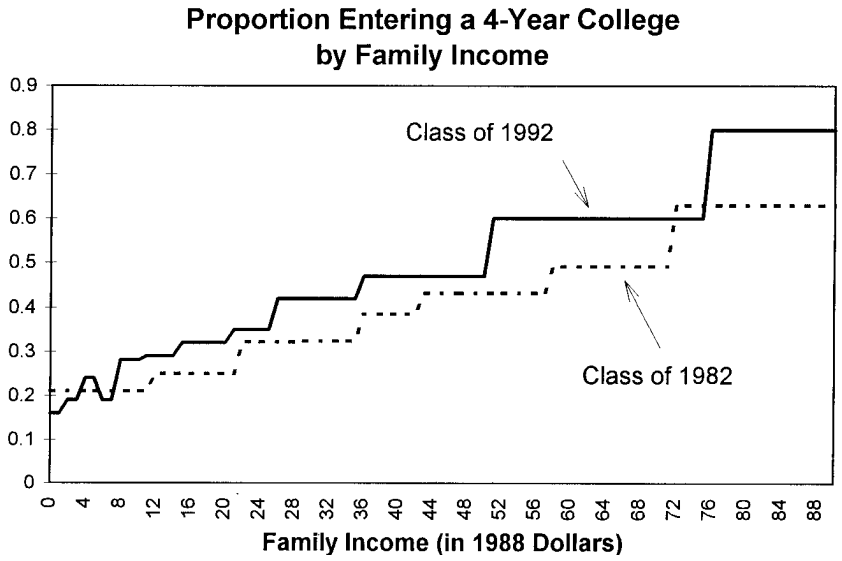
the wake of this latest attempt at incremental reform, we will be left with an even more complicated morass of financial aid programs, which will continue to leave families baffled about the amount of aid available and which potentially distorts family savings and investment decisions. The final section of the paper provides some ideas for how to tackle these longer term issues with more far-reaching structural reform.

A Simmering Crisis in Higher Education

As reported by newspapers around the country, college tuition has risen sharply over the past decade and a half. Between 1980 and 1995, the average tuition (including required fees) at public and private 4-year colleges grew by 91 percent and 83 percent respectively, even after taking account of overall changes in consumer prices.[2] Increases of such magnitude usually provoke a response. Therefore, it was only a matter of time before the U.S. House of Representatives held hearings on "cost escalation" in higher education in the summer of 1996. In a confrontation repeated in state legislatures around the country, uncomfortable college presidents have been forced to extol the social benefits of higher education, while student representatives complained about rising debt burdens. What lies behind the recent tuition increases?

There have been four basic economic and demographic forces pushing us into the current crisis: First, the labor market value of a college education has increased dramatically. In 1979, the average male college graduate earned 49 percent more annually than the average high school graduate. By 1993, that differential had nearly doubled, to 89 percent. Not surprisingly, families and students have been responding: the proportion of college-age youth enrolled in college grew by one-third between 1980 and 1995, from 26 percent to 34 percent.[3] Over the same time period, the number of associate, bachelor's and doctoral degrees awarded grew by 28 percent, 25 percent and 29 percent, respectively.

Second, in the face of rising public college enrollments, state governments have been unable to continue paying the same proportion of the cost for each student enrolling in higher education. At public colleges and universities, tuition increases have far outstripped underlying increases in costs per student. Between 1980 and 1995, real public tuition levels rose by 91 and 72 percent respectively at public four-year and two-year institutions—even though the educational costs per student (including faculty salaries, library costs, student support services, etc.) rose by just 20 percent.[4] In other words, the price that students pay has been rising much more quickly than the actual costs per student at public colleges and universities. States—which have traditionally paid a large share of the costs with direct subsidies to institutions—have been compelled by other demands on their budgets to cut their subsidies per student and to raise the share of costs paid by students and their families. It is this decline in the share of costs covered by state subsidies—as opposed to a sharp increase in costs themselves—which accounts for a majority of the increase in tuition at public institutions, enrolling three-quarters of 4-year college students.



The story has been different at private colleges. First, while "sticker prices" increased by 83 percent between 1980 and 1995, the price paid by the average student rose by only half that rate, after taking account of offsetting increases in institutional grant aid. With the decline in federal need-based grant aid discussed below, private universities have increasingly used the tuition paid by some students to keep costs down for other students. On the other hand, cost increases—rather than declines in public subsidies—were larger at private 4-year universities than at public universities. Costs per student rose by approximately the same amount as net tuition paid per student—over 40 percent. Despite a careful analysis by Clotfelter (1996), the sources of this increase in costs at private institutions is not very well understood. Rising costs are a problem at private institutions. But, to keep the issue of cost escalation in higher education in perspective, such institutions enroll only 25 percent of all 4-year college students.

Third, the federal government—with budgetary concerns of its own—has not filled the ever-increasing financial need created by rising public tuition. The real value of the maximum Pell Grant award—a useful gauge of the aid available for the lowest-income students—fell by 35 percent between 1979–80 and 1995–96. Yet total Pell Grant spending actually increased by nearly 10 percent over the same period. The explanation: changes in the benefit reduction formula, increased enrollments in college and rising tuition levels have all raised the cost of guaranteeing a given level of aid.

Fourth, low-income students—who are particularly price sensitive—seem to have fallen behind as enrollment rates have increased overall. Figure 1 compares the proportion of students entering a 4-year college within two years of high school graduation by family income level, for the high school classes of 1982 and 1992.[5] Clearly, the proportion of high school students entering college has increased. But the increases have been particularly large among those from families with incomes above $50,000. Entry rates were stagnant for those with incomes below $12,000. Given the increasing importance of a college education, this widening gap in college enrollment rates between youth in high and low-income families has disturbing implications for future inter-generational mobility. Moreover, there is some evidence that the gap between high- and low-income youth increased more in states with the most rapid public tuition increases.[6]

Finally, the pressure to spend more on higher education is likely to get worse. The size of the college-age population—which has declined by 15 percent since 1980, partially relieving the cost pressures from rising college enrollment rates—is projected to rise by one-fifth over the next 15 years.[7] The renewed expansion of the college-age population is expected to be even more rapid in California, where the population of 15–24 year-olds is projected to rise by twice the national rate.[8]

Simply put: Although labor market trends seem to justify sending more youth to college, a college education is a very expensive undertaking—costing approximately $12,000 year at the average public 4-year institution, not counting room and board costs and the value of the student's time out of the labor market. As existing federal and state subsidies for higher education are being stretched thin, families are paying a larger share of the costs. If college enrollment rates remain high—and it seems prudent to expect so, given conditions in the labor market—public subsidies will have to go even further. The long-term challenge is to do so equitably and efficiently.

THE CURRENT APPROACH TO FINANCING HIGHER EDUCATION

State, local and federal governments primarily employ two types of subsidies to help families pay for higher education. First, and by far the largest, are the direct appropriations from state and local governments to public postsecondary institutions. In 1993–94, the state and local governments appropriated $45 billion in subsidies to public institutions of higher education, the vast majority of which were used to keep tuition charges low for all students, rather than providing means-tested grants.[9]

Sparking a lively debate more than two decades ago, Lee Hansen and Burton Weisbrod (1969) argued that such broad-based subsidies to public institutions were "regressive," since middle and higher income families were most likely to attend the elite 4-year institutions which received a large share of such subsidies.[10] (See the relationship between college-going and income in Figure 1.) Critics, most notably Joe Pechman (1970), responded that the net progressivity (or regressiveness) of subsidies depended not only on the income distribution of public college students, but also on the marginal source of revenue used to pay for public higher education. Pechman argued that if state income taxes were the marginal source of revenue, then, on net, public subsidies to higher education may still be equitably distributed, since higher income families pay a disproportionate share of public subsidies for higher education as taxpayers. An obvious difficulty is that it may be difficult to identify the marginal source of revenue for higher education.

The second largest form of public subsidy to higher education are "means-tested" grant and loan programs to help families pay for college. The largest of these is the federal Pell Grant program, currently distributing approximately $6 billion per year in grants to low-income youth and adults. Most states also have their own grant programs to supplement the Pell Grants, although total spending on state need-based grant programs was roughly one-half the size of the Pell Grant spending. In addition, the federal government spends several billion dollars per year to pay the interest on loans for students in school and to pay off defaulted loans.

With the exception of the defaulted loans, most of this aid is distributed according to a "backward-looking" assessment of a student's ability to pay. For dependent undergraduates (defined as those who are not married, under age 24, with no military experience and no dependents), eligibility for aid is based not only upon their own income and assets, but also upon parental family income and financial assets. Such "backward-looking" means-testing implicitly taxes income and savings, by providing less aid to those with higher incomes and assets. Because only a single year of income (the prior tax year) is considered and because the implicit marginal levy on savings (5.6 percent) is repeated each year that one has a child in school, these marginal tax rates can be become quite large.[11] Edlin (1993) and Feldstein (1995) estimate that the marginal tax on savings can reach nearly 50 percent for those with children in college over a span of 8 years.[12]

Though still high, the implicit tax rates may not be as high as these estimates imply. First, as Case and McPherson (1986) point out, the marginal tax rate for financial aid is zero for those whose incomes are already too high to qualify for financial aid. Three-quarters of 4-year college students attend public 4-year universities with an average tuition of approximately $3000. Relatively few of those with incomes in the top income bracket or with financial assets larger than the asset protection allowances would be qualifying for any aid at these low-cost institutions. Second, the tax rates calculated by Edlin and by Feldstein assumed that any difference between the cost of attendance and the "expected family contribution" was being met. Yet, as Dick and Edlin (1996) report, the average college does not meet students' full financial need. Rather than a 50 percent tax on savings, Dick and Edlin estimated a marginal asset levy of 8 to 26 percent and marginal income taxes of 2 to 16 percent for those attending the average-priced college. Though smaller than a superficial inspection of the financial aid formula would imply, these tax rates are clearly not negligible.

THE ADMINISTRATION'S PROPOSAL

The President has proposed two major changes to the way we finance higher education: an increase Pell Grant spending of roughly $9 billion over the next 5 years; and a new tax credit and tax deduction for college expenses, estimated to cost approximately $36 billion over the same period.[13]

The proposed increase in Pell spending is the result of two roughly-equally-costly changes in the student aid programs. First, the maximum Pell grant would be raised to $3000 from $2700 for the 1997–98 school year. A $3000 maximum grant would still be below the 1979–80 level of $3500 (after inflating by the CPI), but it represents a very substantial rise from the level of $2400 in the first year of the Clinton Administration. Second, the "income protection allowance" for single, independent students would be raised from $3,000 to $9,150—allowing older, independent students to earn more before having their income taxed away by the student financial aid formulae.

The proposed tax credit would be a 100 percent credit on the first $1500 in tuition expenses per person for a first year. Family members would qualify for a second year by maintaining a "B average." The value of any Pell Grants received would be subtracted from the value of a credit. Eligibility would be phased out for families with adjustable gross income (AGI) between $80,000 and $100,000 for single and head-of-household returns between $50,000 and $70,000. The credit would be nonrefundable and family members would have to be enrolled at least "half-time" in a degree program at an institution qualifying for the student financial aid programs administered by the Department of Education.

The proposed deduction would allow families to deduct up to $10,000 in tuition expenses, for those attending at least half-time in a degree program. As proposed, the deduction would be an "above-the-line" deduction, available to those not itemizing. The deduction would be subject to the same income phase-outs as the credit. Unlike the credit, there would be no limit on the number of years a family could file for the education deduction, and there would be no grade requirements.

Eligible families would have the choice between taking the $1,500 credit or the $10,000 deduction. For a family member in college for the first or second year, those in the 15 percent tax bracket will generally prefer the credit if they qualify. However, regardless of their grades, those in the 28 percent tax bracket paying more than $5357 for tuition should choose the deduction, since the deduction will be worth more (i.e. .28*$5,357=$1,500).

Table 1 portrays the combined value of the Pell Grant increase and the tax changes for four groups of students: "dependent" and "single, independent" students attending the public and private 4-year institutions, with average tuition and required fees of $2860 and $12,432 respectively.[14] As reported in Table 1, the largest single beneficiaries of the proposal would be single, independent students. Under current law, these students lose $.50 in Pell Grants for every dollar of earnings above $3,000. In other words, with the current maximum of $2700, an independent students with just over $8,000 in income does not qualify for any Pell Grant. The proposal would allow these students to protect more of their income, but would keep the marginal tax rate the same. The second largest beneficiaries would be dependent students in the 28 percent tax bracket attending expensive private universities. Table 1 should be interpreted in combination with Figure 1. Because higher income families are more likely to go to college in the first place (and more likely to attend expensive private schools when they do), they are more likely to benefit from the proposal.

ADMINISTRATIVE CONSIDERATIONS

As with any new tax expenditure, the proposed credit and deduction creates a number several novel problems of enforcement for the Internal Revenue Service. Probably most important, the IRS would face a difficult task preventing families from using the tax credit for the purchase of leisure-related coursework. To cite an extreme example, a local university could charge middle and higher income adults up to $1,500 for a series of whale-watching tours, offer these new "students" credit toward a marine biology degree and the federal government could end up subsidizing the whole affair. Without monitoring course content directly, the IRS will find it difficult to prevent such abuse by relying on "degree-seeking" status and "half-time" enrollment alone. This is an inevitable result of providing a 100 percent tax credit. With $1500 of pure subsidy at stake, families and institutions are likely to use some ingenuity in finding ways to qualify for the credit.

Second, tax years generally do not overlap with academic years. As a result, since most academic programs start in the fall, students applying for the first year of their tax credit will have paid only one-semester in tuition. The "B-average" require-

ment would typically apply to their first semester in college. The second year of eligibility for the tax credit will most often apply to the spring of their first academic year and fall of their second academic year.

Third, the "B average" requirement for those seeking a second year of tax credits will be very difficult to police. Including various branch campuses, there are more than 3700 two-year and four-year colleges in the United States. Many have unique grade accounting schemes that do not meet the standard 4-point grading scale. As a result, verifying student grades is likely to be a challenge.

Of the three administrative concerns described above, the "B average" requirement will probably be less troublesome than policing the "half-time, degree seeking" requirement, but it may also be an unnecessary administrative complication. Presumably, the purpose of the requirement is to improve students' incentives to study in college. However, it may have precisely the opposite effect, if student's choose to take less challenging coursework or if colleges adjust their grading scales. Moreover, the grade requirement probably fails an equity test as well, since it disproportionately benefits higher-income students. While the "half-time, degree-seeking enrollment" requirement is imperfect and may prove difficult to enforce, it is a fundamental safeguard against abuse. The "B average" requirement is costly and is probably an unnecessary complication.

THE PROSPECTS FOR TUITION INFLATION

Despite the fears of some of the plan's critics (and, perhaps, the hopes of some of the plans supporters in the higher education community), I do not believe that the proposal will lead to rampant tuition inflation. The reason: although the plan may provide welcome tax relief to families, it has little effect on the marginal cost to families when an institution raises tuition. Except for those paying less than $1,500 in tuition expenses, the most tax relief a family will receive when their college raises tuition will be between $.15 and $.28 on the dollar—and that would cover only those tuition increases up to $10,000. Moreover, the only families receiving this tax relief will be first- and second-year students from families in the 28 percent tax bracket paying between $5,357 and $10,000 and students later in their careers paying between $1,500 and $10,000. Most others—first and second-year students paying less than $5,357, first and second-year students in the 15 percent tax bracket (who will be using the credit rather than the deduction), students with incomes too high to qualify for tax relief and those paying more than $10,000 in tuition—will all be paying 100 percent of any tuition increase. Facing prospects of declining enrollments or the political resistance of angry parents, colleges may properly hesitate to raise tuition.

The primary impact of the proposal will be an income effect, rather than a price effect—as if the federal government were sending families a tax refund unrelated to how much more they spend on college. Families will spend some of these tax savings on higher education, but are likely to spend most of it on other consumption—such as a summer vacation or new furniture. Colleges may capture a portion of the benefit when families choose to consume more education with their tax windfall, particularly those colleges with considerable market power. But, in the end, relatively little of the tax relief is likely to make it into faculty salaries, dormitories and libraries.

Depending upon how institutional financial aid is treated, the proposal could have a larger effect on how colleges distribute financial aid. If institutional grant aid is to be treated like Pell Grant aid—subtracted from both the credit and the deduction—colleges will have a strong incentive to cut their own institutional aid, since any such aid would be taxed at 100 percent for the first $1500 in aid for those receiving the credit.

Whereas many colleges may be hesitant to raise student charges on the margin, they will have a strong incentive to re-label other student charges as "tuition" in order to allow families to claim the credit or deduction. Under current law, there is no incentive for colleges to shift room and board expenses into tuition charges, since they are treated equivalently in the student aid formulae. However, those colleges with current tuition charges below $10,000 (primarily public institutions) will have a strong incentive to begin to charge on-campus students "tuition" for access to dormitory study halls, etc. Given that a fifth of the 6 million students at public 4-year colleges live on campus and pay room and board charges averaging roughly $4,000, there is a possible additional tax expenditure of $1.3 billion if these institutions shift room and board charges into student tuition (assuming that families are at the 28 percent tax bracket). Although the Treasury department is likely to succeed in developing regulations preventing some of this shifting, an upper bound estimate would represent an 18 percent increase over the current estimated cost.

EQUITY

Many have criticized the plan for providing large subsidies to middle and higher-income families attending expensive private institutions, and smaller amounts to the lowest income families receiving Pell Grants. However, a full consideration of the distributional implications of the current proposal is complicated by the President's and Congress' commitment to proposing a budget that will be "balanced" in 2002. Given this consensus, it may be wrong to assume that frugality on the tuition tax credit and tax deduction proposals will mean a greater contribution toward reducing the national debt or greater prospects for increased student aid in the future. In fact, if the President and Congress are serious about the 2002 target, then a smaller education tax credit or tax deduction is likely to mean either a larger capital gains tax increase or smaller Medicare cuts. Although they may rightly criticize the plan on grounds of economic inefficiency, many of those criticizing the plan on grounds of equity may find these alternatives even less appealing.

A MORE FAR-SIGHTED APPROACH TO REFORM

The Administration's proposal would provide tax relief for families struggling to pay tuition bills. It would also provide some additional assistance to low-income youth attempting to pay for college—particularly for older, low-income, single students going back to school. Just like the large across-the-board subsidies provided by state governments to students attending public colleges, the Administration proposes using public revenues to keep families out-of-pocket expenses down while students are enrolled in school.

However, given the economic and demographic forces pushing college enrollment rates up, the real challenge over the next decade will be to design a financial aid system, which does not discourage family earnings or savings, which encourages students to make the most of the value of the resources at their disposal, and which allows students from all family backgrounds to make worthwhile investments in college. While providing short-term relief, the Administration's proposal does nothing to solve some of the structural weaknesses in our current system for financing college. Indeed, it may complicate matters. The reauthorization of the Higher Education Act this year provides an opportunity to fundamentally rethink how those subsidies are to be provided in order to maintain access for all groups. In contributing to that discussion, I would add the following observations.

First, simplicity and transparency should be fundamental policy objectives. Information on federal financial aid is primarily delivered by college financial aid offices, offering financial aid "packages" to the students who apply for aid. One strength of such a system is that the mixture of grants, loans and work-study can be narrowly tailored to meet the particular needs of each student. However, an often-overlooked weakness is that parents and students are often uncertain about the extent of aid available up until the time that they receive their "package." Ironically, those whose decisions we would most hope to affect—those who would not be going to college in the absence of aid—are least likely to navigate the system easily and anticipate the amount of aid available.

The mystery surrounding the financial aid application process may explain a long-standing puzzle in research on higher education. On one hand, most research that has compared college enrollment rates in high and low-tuition states has found that those states that have high public tuition levels tend to have lower enrollment rates, all else equal. As hinted above, this is particularly true for low-income youth. On the other hand, there is very little evidence of any disproportionate increase in college enrollment among low-income youth between the early Seventies and late Seventies when many of our federal programs were expanded.[15] (The Pell Grant program was established in 1973.) The answer to the puzzle may lie in the fact that low-income students on the fence about entering college know about public tuition levels—which they hear about on the radio or read in newspaper headlines—but they may be less able to anticipate the availability of aid or to fulfill all the bureaucratic hurdles on the way.

The complications surrounding financial aid policy limits its effect and adds to parents anxiety. However, it is largely unnecessary. For example, parents and students could be offered a clearly stated guarantee of an amount of aid (e.g. up to $5000) to finance each year of undergraduate study. Although the mixture of grants, loans and work-study one received could still depend upon one's own circumstances, there is no need to leave the total amount of available aid in question. Students would at least know how much they would have to finance out of their own pocket, and could plan their career choices accordingly. Another approach would be to grant presumptive eligibility to those receiving other means-tested programs—Food

Stamps, Aid to Families with Dependent Children and the Earned Income Tax Credit—and inform these families of their likely benefits.

Second, income contingent loan forgiveness provides an alternative form of means-testing. Most of our current financial aid programs are provided on a "backward-looking" basis. For instance, eligibility for Pell Grants and subsidized federal loans is based upon a family's and youth's income and assets in the prior year. In contrast, the income-contingent loan option (created during the 1992 re-authorization) makes a "forward-looking" evaluation of a person's means—forgiving remaining balances for those with low incomes for 25 years after college. Though the repayment schedule in the current program has been designed primarily to lengthen the duration of repayment rather than forgive many loans, the program could easily be adapted to be more generous.

As an alternative to the traditional form of means-testing in student aid, forward-looking means-testing has several advantages: First, it offers "insurance" to both high- and low-income families concerned about whether their children will be able to shoulder their student debt. Parents and students may value the additional peace of mind even if they never actually have to sign up for the income-contingent repayment option. Second, forward-looking means-testing does not involve the same difficulty in distinguishing "dependent" students—whose parents' resources are considered in the determination of need—from "independent" students. The distinction between "dependent" and "independent" students becomes moot if subsidies are dispersed on the basis of future incomes, rather than on a single year of income and assets. Third, the most onerous administrative burden imposed by our financial aid system—that parents and students spend long hours each year filing complicated financial aid forms—could be lightened if a larger share of available subsidies were provided on a forward-looking basis. Indeed, transferring other loan subsidies—in-school interest subsidies, preferential rates on Perkins Loans, etc.—into income contingent loan forgiveness would relieve millions of parents of the need to file financial aid forms every year to establish their eligibility. Only those seeking institutional aid (primarily the quarter of students that attend private 4-year institutions) or Pell Grant or Federal Work Study aid would have to file a financial aid application. Fourth, "forward-looking" means-testing can greatly diminish the marginal tax rates on income and savings implicit in the financial aid formula, since subsidies would be based upon an entire career of income rather than a single year.

Finally, federal spending should complement and not just substitute for state spending. State governments continue to provide the lion's share of subsidies to higher education. The federal government should be looking for ways to help state governments stretch their resources rather than simply substitute for them. One idea would be to offer states the opportunity to "buy into" the federal loan programs, reimbursing the federal government for providing more favorable interest rates or income-contingent repayment schemes to their residents. Given the mobility of the Nation's population across state lines, the federal government is in the best position to operate an income-contingent repayment scheme efficiently. In order to buffer the effect of public tuition increases, states may be interested in helping to provide more favorable loan terms to their residents.

CONCLUSION

It is no coincidence that, as the labor market increasingly values educational attainment, calls to improve the education system have become ever louder. Reformers have offered a long list of suggestions for improving the quality of elementary and secondary education—ideas such as school choice, national standards and greater accountability at the school level.

Many of these proposals—particularly those that improve accountability and flexibility for individual schools—have merit. However, it would be an understatement to say that additional investments in the K–12 sector are not a fool-proof investment. Ever since the publication of Equality of Educational Opportunity in 1966 (commonly known as the Coleman Report), researchers have argued over whether marginal increases in school spending have been associated with improved student performance.

There is no need to enter the fray over whether "money matters" in elementary and secondary education. That literature is well-established and inquiry is ongoing. However, I would suggest that we should investigate the prospects for investing along a different margin: improving not only the quality of elementary and secondary schooling, but also investing in the quantity of schooling received by youth, by better-targeting existing subsidies for higher education. Although structural reforms in elementary and secondary education may yet bear fruit, it is time that we recon-

sidered how our current subsidies to higher education are affecting the nation's investment in human capital.

Table 1. Impact of the Administration's Proposal by Family Income and Type of College Attended

Unadjusted Family Income:	Add'l Pell Grant:	Tax Credit:	Tax Deduct:	Total Benefit:	
				First 2 Yrs College:	Later Years College:
Dependent Student at a 4-Year Public University					
$0–20,000	300	0	0	300	300
$30–50,000	0	1,500	429	1,500	429
$60–80,000	0	1,500	801	1,500	801
$117,000+	0	0	0	0	0
Single Independent Student at a 4-year Public University					
$10,000	3,000	0	0	3,000	3,000
$15,000	1,450	50	0	1,500	1,450
$20–30,000	0	1,500	429	1,500	429
$40–50,000	0	1,500	801	1,500	801
$77,000+	0	0	0	0	0
Dependent Student at a 4-Year Private University					
$0–20,000	300	0	0	300	300
$30–50,000	0	1,500	1,500	1,500	1,500
$60–80,000	0	1,500	2,800	2,800	2,800
$117,000+	0	0	0	0	0
Single Independent Student at a 4-year Private University					
$10,000	3,000	0	0	3,000	3,000
$15,000	1,450	50	0	1,500	1,450
$20–30,000	0	1,500	1,500	1,500	429
$40–50,000	0	1,500	2,800	1,500	801
$77,000+	0	0	0	0	0

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ENDNOTES

1. President Clinton, State of the Union Address, February 1997
2. U.S. Department of Education (1996), Table 309, p. 320.
3. U.S. Department of Education (1996), Table 182, p. 189.
4. These figures include the costs of instruction, administration, student services, libraries and the operation and maintenance of colleges physical plants, but exclude expenditures on scholarships. Figures were adjusted for increases in consumer prices. (U.S. Department of Education (1996), Tables 339–340, pp. 352–353.)
5. The estimates in Figure 1 are based upon the author's tabulation of the High School and Beyond Survey of those with high school diplomas from the class of 1982 and the National Education Longitudinal Study of those graduating from high school in 1992.
6. For more on this, see Kane (1995).
7. U.S. Bureau of the Census, Statistical Abstract of the United States, 1995, Table 17, p. 17.
8. Callan and Finney (1993).
9. U.S. Department of Education, Digest of Education Statistics, 1996, p. 334.
10. Between 1970 and 1977, the Journal of Human Resources was inundated by at least 7 separate responses to an article by Hansen and Weisbrod in that journal.
11. For more on implicit tax rates in financial aid formulae, see Edlin (1993), Feldstein (1995) and Dick and Edlin (1996).
12. The average tax rates on savings remain low, however, given asset protection allowances of $36,000 for married parents at age 45, ranging up to $66,000 for parents 65 and older.
13. Although the Administration has also proposed several other initiatives related to higher education (allowing parents to make penalty-free withdrawals from IRA's to pay for college tuition, extending the exclusion of employer-provided education benefits, a new 10 percent tax credit for expenditures on employee training by small employers and Presidential scholarships for students in the top 5 percent of their high school class), I do not discuss those proposals here.
14. Single independent students were assumed to have no dependents and no savings above the asset protection allowances. The dependent students were assumed to come from a two-parent, two-child family with only one student in college and no assets above the asset protection allowances. Moreover, I assumed that none of these students were receiving institutional grant aid.
15. For more on this issue, see Kane (1994, 1995), Hansen (1983) and McPherson and Schapiro (1991).

Note: The views expressed in this statement do not necessarily reflect those of the staff members, officers or trustees of Harvard University.

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Mr. RAMSTAD. Thank you, Mr. Kane.
Dr. Schapiro.

STATEMENT OF MORTON OWEN SCHAPIRO, PROFESSOR OF ECONOMICS, AND DEAN, COLLEGE OF LETTERS, ARTS AND SCIENCES, UNIVERSITY OF SOUTHERN CALIFORNIA

Mr. SCHAPIRO. Thank you, Mr. Chairman. There are sound reasons to support the President's commitment to expand Federal funding for higher education. Economic returns to attending our Nation's colleges and universities are at historic highs, and there are few who would dispute the great value of the noneconomic returns as well.

At the same time, Federal dollars to support students' efforts to get a college education are and will be very scarce. We must do our utmost to use those precious dollars well.

This is a time of great achievement, but also of great challenge for American higher education. Despite extraordinary real increases in tuition over the past two decades, the percentage of high school graduates attending college is around 60 percent, as Professor Kane pointed out, an all-time high.

It isn't difficult to explain why. While in 1980 a student graduating from college could expect to earn about 45 percent more than a high school graduate, today the differential has almost doubled, to 85 percent. Economic studies place the rate of return to an investment in a college education at more than 10 percent, a figure that compares quite favorably with stocks or bonds.

So even in the narrowest economic terms, higher education is a sound investment. When one adds the important noneconomic benefits, the case for allocating more money to postsecondary education is even clearer.

Yet there are significant challenges facing higher education today. Even as overall college attendance rates have grown, the gap between enrollment rates of students from richer and poorer families has widened.

Moreover, for low-income students in many States, the range of institutional types within higher education is becoming increasingly restrictive. Rising prices at public universities and 4-year colleges, coupled with inadequate student aid for the neediest students, are forcing an increasing percentage of students from low-income families to attend their local community colleges, whether or not that is the best alternative for them in light of their aspirations and capacities.

Evidence developed in our work and by other researchers shows that subsidies to low-income students are much more effective in stimulating enrollment and expanding educational choice than are subsidies to students from more affluent families.

There is in our view no question that rising public tuitions, coupled with inadequate student aid, have produced a crisis of college affordability for many low-income, and some middle-income families.

Expanded Federal investments in higher education are a worthy way to attack this growing problem. But if our premise is accepted, the central questions before this Congress are two: First, what is the most effective vehicle for expanding Federal higher education investments, and, second, which students should be the target of such an expansion.

Mr. SCHAPIRO. I now turn to my colleague, Michael McPherson.

STATEMENT OF MICHAEL S. McPHERSON, PROFESSOR OF ECONOMICS AND PRESIDENT, MACALESTER COLLEGE, ST. PAUL, MINNESOTA

Mr. MCPHERSON. With your permission, we're doing this on kind of a tag team basis. So I'll follow through on Morty's beginning.

It is our belief that direct increases in spending on Federal grant programs for college students are a more straightforward, more transparent and more effective vehicle for expanded Federal spending than our new Federal tax breaks.

Nonetheless, we must also recognize that in the current political climate, tax breaks may be more politically saleable than are spending increases that have equivalent impacts on families and on the Federal Treasury.

In this light, we believe that the attractions of a tax cut program for higher education depend critically on the targeting of the bene-

fits. Unfortunately, the most recent incarnation of the President's tax proposals has some serious drawbacks.

As we have said, low-income families have suffered the greatest reduction in educational opportunity, yet the Clinton tax credit proposal denies tax benefits to those who receive $1,500 or more in Pell grants, generally low-income students, while neither the tax deduction nor the credit provide benefits to the lowest income families who do not have enough taxable income to qualify for tax relief.

Moreover, the tax deduction the President has proposed will provide greater benefits to persons in higher tax brackets, a result which is hard to justify, either in terms of distributive equity or in terms of efficiency in generating higher college enrollments.

President Clinton's proposals could thus be substantially improved by focusing on credits rather than deductions, by allowing students to benefit from both tax credits and Pell grants, by eliminating the B-average requirement, by making the credits refundable, and by limiting credits for families with higher incomes.

Such improved targeting of benefits would make the consequences of this program of tax benefits similar to an expanded Pell grant program, an alternative that is in our view more desirable as policy, but that may well be politically infeasible.

We're encouraged by the President's proposal to increase the maximum Pell grant from $2,700 to $3,000, but over the past 15 years college tuition has risen by more than 75 percent, relative to inflation, while the maximum Pell grant has fallen by about a quarter.

To restore the real value that the Pell grant had in 1980, we'd need a grant of around $4,000. If an increase of this magnitude is out of the question, then an alternative way to get money to those low-income students who desperately need it should be considered.

The fact that the President seeks to expand Federal funding for higher education is laudable. Economic studies clearly support such an expansion, but the question we have to ask is whether the massive new inflow of funds that is being proposed will really open the doors of college education wider than ever before.

We believe the Nation needs a higher education program that has more benefits to the students for whom the issue of college affordability is the most pressing. Thank you.

[The prepared statement follows:]

Statement of Michael S. McPherson, Professor of Economics and President, Macalester College, St. Paul, Minnesota, and Morton Owen Schapiro, Professor of Economics and Dean, College of Letters, Arts and Sciences, University of Southern California

There are sound reasons to support the President's commitment to expand federal funding for higher education. Economic returns to attending our nation's colleges and universities are at historic highs, and there are few who would dispute the great value of the non-economic returns as well.

At the same time, federal dollars to support students' efforts to get a college education are, and will be, very scarce. We must do our utmost to use those precious dollars well.

This is a time of great achievement and great challenge for American higher education. Despite extraordinary real increases in tuition over the past two decades, the percentage of high school graduates attending college is around 60%, an all time high. It isn't difficult to explain why: while in 1980 a student graduating college could expect to earn about 45% more than a high school graduate, today the differential has almost doubled to 85%. Economic studies place the rate of return to

an investment in a college education at more than 10 percent, a figure that compares quite favorably with stocks or bonds. So, even in the narrowest economic terms, higher education is a sound investment. When one adds the important noneconomic benefits, the case for allocating more money to postsecondary education is even clearer.

Yet, there are significant challenges facing higher education today. Even as overall college attendance rates have grown, the gap between enrollment rates of students from richer and poorer families has widened. Moreover, for low-income students in many states, the range of institutional types within higher education is becoming increasingly restricted. Rising prices at public universities and four-year colleges, coupled with inadequate student aid for the neediest students, are forcing an increasing percentage of students from low-income families to attend their local community colleges, whether or not that is the best alternative for them in light of their aspirations and capacities. Evidence developed in our work, and by other researchers, shows that subsidies to lower income students are much more effective in stimulating enrollment and expanding educational choice than are subsidies to students from more affluent families.

There is, in our view, no question that rising public tuitions coupled with inadequate student aid have produced a crisis of college affordability for many low-income and some middle-income families. Expanded federal investments in higher education are a worthy way to attack this growing problem. If our premise is accepted, the central questions before this Congress are two. First, what is the most effective vehicle for expanding federal higher education investments? Second, which students should be the target of such an expansion?

It is our belief that direct increases in spending on federal grant programs for college students are a more straightforward, transparent, and more easily managed vehicle for expanded federal spending than are new federal tax breaks. Nonetheless, we must also recognize that, in the current political climate, tax breaks are more politically saleable than are spending increases that have equivalent impacts on families and on the federal treasury.

In this light, we believe that the attractions of a tax cut program for higher education depend critically on the targeting of the benefits. Unfortunately, the most recent incarnation of the President's tax proposals has some serious drawbacks.

As discussed above, low-income families have suffered the greatest reduction in educational opportunity. Yet the Clinton tax credit proposal denies tax benefits to those who receive $1,500 or more in Pell grants—generally low income students—while neither the tax deduction nor the credit provide benefits to the lowest income families who do not have enough taxable income to qualify for tax relief. Moreover, the tax deduction the President has proposed will provide greater benefits to persons in higher tax brackets—a result which is hard to justify either in terms of distributive equity or in terms of efficiency in generating higher college enrollments.

President Clinton's proposals could thus be substantially improved by focusing on credits rather than deductions, by allowing students to benefit from both tax credits and Pell grants, by making the credit refundable and by limiting credits for families with higher incomes. Such improved targeting of benefits would make the consequences of this program of tax benefits similar to an expanded Pell grant program—an alternative that is, in our view, more desirable as policy but that may well be politically infeasible.

We are encouraged by the President's proposal to increase the maximum Pell grant from $2,700 to $3,000. But over the past 15 years college tuition has risen by more than 75 percent over and above inflation while the maximum Pell grant has fallen by about a quarter. To restore the real value that the Pell grant had in 1980, we would need a grant of around $4,000. If an increase of this magnitude is out of the question, then an alternative way to get money to those low-income students who desperately need it should be considered.

The fact that the President seeks to expand federal funding for higher education is laudable. Economic studies clearly support such an expansion. But the question we have to ask is whether the massive new inflow of funds that is being proposed will really "open the doors of college education wider than ever before." We believe the nation needs a higher education program that has more direct benefits to the students for whom the issue of college affordability is the most pressing.

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Mr. RAMSTAD. Thank you, Dr. McPherson. And also I just wanted to say that we're very, very pleased we were able to lure you from Williams College to accept the presidency of Macalester last sum-

mer. And your tag team, I know, has also authored several books on financing higher education.

So we appreciate your expertise, and I look forward to the questions. Thank you again for being here with us today.

Mr. Breneman.

STATEMENT OF DAVID W. BRENEMAN, PROFESSOR AND DEAN, CURRY SCHOOL OF EDUCATION, UNIVERSITY OF VIRGINIA

Mr. BRENEMAN. Thank you, Mr. Chairman. I want to make it clear at the beginning that in my remarks I'm speaking strictly for myself as an economist who has worked in this area a bit, as a former president of a private college in Michigan, and currently dean at a public university.

As with my fellow panelists, I am very delighted that the President and the Congress is taking very seriously a commitment of additional resources to higher education. I think the trick, however, is to make sure we do this in the wisest possible way.

One of the common criticisms of tuition tax credits and deductions, going back many years, is the notion that they represent essentially a dead weight loss, that they don't alter anybody's behavior.

I think that represents a problem with some of these proposals, as well, that many of the benefits will go to people whose behavior won't be changed by the presence of the credit or the deduction.

There is one group of institutions, however, or one group of players where behavior may be affected, and I'll pose the extreme case by which to make a point, and acknowledge that there is likely to be some range of behavior.

First, within those institutions where students apply for student aid, financial aid, and many of the students in the beneficiary category are likely to be doing that, the student aid office has a very simple and direct way of converting this credit into institutional aid. That is, they simply treat it as another external resource of funding higher education, and offset their own support for student aid against it.

This is an invisible process. It does not involve an increase in posted tuition. It simply means that the institution captures some or all of the credit or deduction for those students who will be eligible for it. And the institutions have all the financial information at their disposal that they need to make that calculation.

So that's one case. Even without a posted tuition increase, it is possible for a certain set of institutions to convert some of this credit into institutional aid.

Another set of institutions don't do a lot of financial aid—2-year publics, many 4-year low-price publics, and the proprietaries. In that case, the only way that they could capture this would be by an overt tuition increase, and in that area we're into essentially a politically determined price, and I don't think there is any analytic way to say what will happen.

The temptation will certainly be present, however, for State officials, as well as college officials, to push tuition up to some degree to capture some of this benefit.

Now, in some cases, right now in my State, Governor Allen has imposed a tuition freeze, so this wouldn't be something we could

do. But the potential is there for this to happen, and it seems to me the only way that one can prevent it from the Federal level is through jawboning, and I guess we all have our own opinions about how effective jawboning is in the long run. But it strikes me that's a pretty weak reed to lean on.

I think another way to think about a tax credit that I'm sure has been on all of our minds is whether you'd like to see this credit turned into a direct expenditure program, having exactly the same features as the credit.

And I submit that a—I'm just now speaking of the credit—a direct, $1,500 credit to families of incomes up to $80,000, and then I guess ratably reduced below that, doesn't strike me as the kind of direct expenditure program most of us would support.

Like my colleagues, I think this kind of money, if we have it available for higher education, would be far better directed toward the Pell grant program, increases in the maximum rate.

I am old enough that I was in town in 1978 under the Carter administration when the Middle Income Student Assistance Act swept over this Hill like wild fire, and it's quite remarkable, because that was triggered by a legislative proposal for a tuition tax credit, and the administration and the Treasury Department were adamantly opposed to this, and began thinking of how they could meet this need in some other way.

And for those who may have forgotten, one of the ways the Congress responded was by taking off all the income limitations on the guaranteed student loan program, the only problem being they happened to do it at a time when interest rates were in double digits.

And so every family in American with a kid in college, arbitraged against the GSL, you know, borrowed to the hilt, stuck the money in a money market fund at 12 percent, and the Treasury very happily paid for several years a very nice benefit to people for that purpose.

Now, the Congress realized its mistake about 3 years later, and reversed this program, but after a considerable cost to the Treasury.

I guess my worry right now is that as middle-income political fears sweep the Congress again that we learn from history and not do something that 3 years from now we will turn around and regret.

Thank you very much.

[The prepared statement follows:]

Statement of David W. Breneman, Professor and Dean, Curry School of Education, University of Virginia

Mr. Chairman, I welcome the opportunity to comment on the administration's proposals for a HOPE scholarship tuition tax credit and an education and job training tax deduction. I comment from the vantage point of an economist who studies higher education finance, and who has served as president of a private college and as dean within a public university.

College affordability is a well-documented concern of many middle and upper income families, as well as for low income families. Education and training are essential for young people of today if they are to have productive and prosperous lives. The entire nation clearly will benefit from increased investment in higher education, and thus I am supportive of the motivation behind these proposals. My concern, however, is that the consequences may not be what the administration claims for these programs. Indeed, I will argue that the result of this legislation will be in-

creased aid for institutions of higher education, rather than tax relief for families. While increased institutional aid may be money well spent, that case should be made directly on its own merits, and not by indirection.

One of the common criticisms of tuition tax credits or deductions for families with incomes up to $100,000, is that behavior is not changed, i.e., students from these families would enroll in any event, and thus the tax benefit is a windfall, a deadweight loss to society. In this instance, however, behavior would be affected, but it would be institutional behavior that would change, not student behavior. Let me explain.

A high percentage of the students who would be covered by these tax benefits would be applicants for student financial aid, institutional aid as well as federal and state aid. Responsible officials in college student aid offices are trained to extract all potential resources from applicants before awarding the institution's own funds as grant aid. Student aid offices also have available detailed financial information on students who apply for aid, so a reasonably accurate estimate could be made for each student of the likely tax benefits made possible by each of these programs. The result will be an additional calculation for each student in the relevant income range, estimating either the value of the credit or the deduction to that family. The aid office, acting responsibly as steward of the institution's own funds, will then reduce any institutional aid that might have been awarded by the maximum estimated tax relief available to the family. The credit or deduction will thus function as an indirect form of aid to institutions, reducing their own aid outlays by the amount of the tax benefit.

It should be noted that, in the case described above, the actual posted tuition rate need not increase for the institution to benefit. In essence, what happens is that the *net* tuition charge to students will increase by the amount of the estimated tax benefits, where net tuition is the actual amount paid by the student after deducting financial aid. In the simplest case of the full $1,500 tax credit, the institution will assume that amount as available to the family, and reduce its own award by $1,500, causing the student's net price to be $1,500 more than it would have been in the absence of the credit. This mechanism is virtually certain to operate for all students eligible for either the credit or the deduction, and who also apply for student financial aid.

There are institutions that award little financial aid from their own resources, and where the above process would not operate as described—these are primarily public two-year colleges, some public four year colleges with very low tuition, and many proprietary schools. For these institutions to benefit from the proposed tax legislation, their posted tuition prices would have to increase, i.e., the increase in *net* tuition is not available to them. The temptation to capture the tax credit or deduction is certainly present, but the outcome is not quite so clear in this case. Public sector tuitions are politically determined prices, and often involve negotiation with the governor, the legislature, or the state coordinating board. Political factors can thus offset economic forces, producing analytical uncertainty. It is not hard to imagine, however, that state officials will see the tax credit and deduction as an opportunity to raise tuition while reducing state appropriations, thereby shifting costs from state to federal budgets. Jawboning from the federal level may be the only way to resist such moves, but it seems unwise to rely on rhetoric to produce the desired outcome.

Let me turn now to another way to think about these tax proposals. When a tax credit or deduction is being proposed as an alternative to a direct expenditure program, it seems reasonable to ask whether one would support the tax proposal if it were presented as a direct outlay. In this case, would one support a grant program that had the features of the tax credit, awarding grants of $1,500 per student to families with joint incomes up to $80,000, and ratably reduced to incomes of $100,000? For anyone who supports the concepts imbedded in the Pell Grant program, such a program would be both inefficient and inequitable. The Pell Grant program has the merit of targeting aid to students for whom the aid makes a difference, i.e., those students who would be unable to attend college without the grant. Does anyone really believe that a grant of $1,500 would make a difference in the college-going decision of a student from a family with $75,000 annual income? The forgone revenue devoted to either the credit or the deduction could buy much more college access if it were added to the existing Pell Grant program in order to raise the maximum grant.

These considerations would be academic if the Pell Grant program were fully funded and delivering the opportunity that it did at its beginning, but that is not

the case.[1] Pell Grants have been underfunded by roughly $6 billion, and thus the forgone revenue caused by the proposed tax expenditures comes at a significant opportunity cost to the major access program of the federal government. Whatever the merits of tax relief to middle and upper income families (ignoring for the moment the earlier argument that little of that benefit would actually accrue to families), one has to weigh that benefit against what a comparable sum could do if allocated to increased Pell Grants. I submit that direct expenditure on Pell Grants is superior on both economic criteria of efficiency and equity.

I am reminded in the current context of the circumstances that led to the passage of the Middle Income Students Assistance Act in 1978. At that time, the Congress was motivated by a desire to help middle income students finance higher education. One of the principal features of that act was to eliminate any income test for the Guaranteed Student Loan (GSL) program. The result was an upsurge of borrowing by middle and high income families, using the funds borrowed to arbitrage against the much higher interest rates available in the market. In other words, families borrowed at the GSL rate of 8 percent, and invested their own funds at the much higher interest rates then prevailing. Having realized this mistake, Congress subsequently undid the damage, but only after considerable needless cost to the Treasury. I see the same situation developing in this current attempt to aid middle and high income families, and I urge the Congress to think carefully before committing a similar mistake.

Thank you for giving me the opportunity to share these thoughts with you.

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Mr. RAMSTAD. Thank you, Dean Breneman, and again, to all the witnesses, our gratitude for being here today.

I would like to begin the questioning, which is a rare pleasure for me, now that I'm a temporary Chairman, by asking the other Members of the panel if you agree with Dean Breneman that we would be better served by putting more resources into Pell grants rather than using the Tax Code for education incentives.

Mr. GLADIEUX. Yes, I certainly agree. I think the Tax Code is not an effective vehicle, as I said, in my testimony, for helping people who are really trying to make ends meet and struggling to meet tuition expenditures.

Direct expenditure programs like Pell and the other grant, loan and work/study programs are just a much more effective way to close gaps in educational opportunity.

Mr. RAMSTAD. Professor Kane.

Mr. KANE. As I said, to the extent there's been a problem in access to higher education over the last 15 years, it's been mostly at the bottom of the income distribution. So I do think moving the money into the Pell program would be a better way to close that gap.

But I would say there are two ways, to improve the tax proposal. One would be to drop the B-average requirement, where even if we could administer it, I'm not sure whether the benefits would justify the costs. A second improvement would be to provide an 80-percent credit for the first $1,875 or a 75-percent credit for the first $2,000 rather than give 100 percent credit for the first $1,500. By requiring some kind of copayment for the initial tuition expense, you might avoid some of the greatest abuse of the system—to subsidize leisure-oriented coursework.

Mr. RAMSTAD. Dr. Schapiro.

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[1] On this point, see David W. Breneman and Fred J. Galloway, "Rethinking the Allocation of Pell Grants," in U. S. Department of Education, *Financing Postsecondary Education: The Federal Role*, Proceedings of The National Conference on the Best Ways for the Federal Government to Help Students and Families Finance Postsecondary Education, U.S.G.P.O., 1996, pp. 23–30.

Mr. SCHAPIRO. Yes, I think Tom Kane is definitely right. If we tinkered with the current bill, we could definitely improve it, but the larger question is one that you asked. Should we expand the Pell grant instead, and I think—feel very strongly that we should. I think everyone here does, and most people who have been studying this, as we have for the last decade or so. It's a much more efficient way to get the money to those who really need it. Otherwise you're going to waste a lot of resources and the bang for the buck is going to be rather minimal.

Mr. RAMSTAD. President McPherson.

Mr. MCPHERSON. Yes, I agree with that.

Mr. RAMSTAD. So we get a five to nothing verdict here.

Mr. GLADIEUX. Mr. Chairman.

Mr. RAMSTAD. Please.

Mr. GLADIEUX. I might add that putting more money into Pell grants not only would increase awards for the very lowest income students, but it would extend benefits further into the middle class.

Student aid is not just for the very poor. It does extend subsidies based on need into the moderate- and middle-income ranges.

Mr. RAMSTAD. I would also like to ask, pursuant to a comment that you made, Dean Breneman, I'd like to ask the college administrators on the panel whether you agree that given the increased administrative costs here to colleges and universities whether we would, as Dean Breneman put it, see tuition inflation pursuant to these increased administrative costs, as well as pursuant to the increased tax benefits.

I believe that was your summary statement, that we're likely to see tuition inflation as a result of increased tax benefits.

Mr. BRENEMAN. Just to clarify, I didn't introduce the administrative cost issue.

Mr. RAMSTAD. No, no. That's my question. I'm asking if similarly you would see that phenomenon, tuition inflation pursuant to the increased administrative costs. Would the colleges and universities pass that down in terms of increased tuition, those administrative costs?

Mr. MCPHERSON. Well, I'll try to respond. I should also say, as other panelists did, that I'm not attempting to speak in any official sense for Macalester College, but rather as a concerned citizen, and somebody who studied this area.

I think the administrative burdens, particularly with the B-average requirement, would be nontrivial. Whether colleges could pass them on would really depend on their market situation, and as Dave Breneman suggested, it's a pretty competitive environment.

So to what extent colleges would absorb those costs, to what extent they would pass them on would probably vary.

But I do think the administrative burdens, both for the B-average requirement, and for verifying expenditures for the sake of tax recording, would be significant.

Mr. RAMSTAD. Thank you, Dr. McPherson. Would anybody else like to comment?

[No response.]

Mr. RAMSTAD. Mrs. Thurman, do you have questions for this distinguished panel?

Mrs. THURMAN. Thank you, Mr. Chairman. I need some help here for a minute. I don't disagree with you on the Pell grants. Let's talk about the direct loan program, because that's also funded through Congress.

Is that another area that we could put additional money in to expand for students? I don't care who answers that. All of you can answer it. Because I will tell you, the University of Florida was one of those institutions that in fact did have the opportunity to participate.

They absolutely love it. The students love it. It's on time. It's easy to administer. They get their money at the beginning of the semester. They are not worried about whether they can pay their tuition, whether their books are going to get paid, whether they are going to have living expenses, utilities. Everything works.

Is that an area that we should be looking to expand, or to make sure that other institutions are covered?

Mr. MCPHERSON. Well, I will offer some response—and I'm sure others will add to it. There are two questions here. I think one is expanding the overall level of lending, and then the question of the vehicle of direct lending versus the guaranty lending program.

As you know, the lending programs are entitlements, so that, given the legislative rules that determine eligibility, as much money as is needed is spent to make the lending programs work. I think the terms of those programs as they stand now reach a lot of people. I'll let others comment on whether we should liberalize those terms in some ways.

I would emphasize that the presence of the direct lending program, I think, has actually made the overall program work better. My place actually works through guarantors and is not participating in the direct lending program.

We're getting terrific service, and I think one of the reasons we're getting terrific service is that there is competition and the banks and the guaranty agencies are alert to the fact that they're working in a competitive environment. So I certainly think it's important to keep the direct lending program going, even though my own college is not currently a participant.

Mrs. THURMAN. Would you like it?

Mr. MCPHERSON. Well, we are really getting very good service now, so it's not clear in my case that it makes sense to change.

Mr. KANE. Also, I know that on the Hill there's been an ongoing debate about the cost comparison between direct lending and the regular loan programs. Actually, I know that's a complicated debate and I'm not sure, in fact, where I come down on it.

But the greatest strength of the direct lending program is the simplification it provides students and their families. As I said at the end of my remarks, we ought to keep in mind that we've got a pricing system that is very complex and confusing for parents and students, and that the more we do to simplify the user interface we are removing some of the uncertainty about how much aid is available and relieving families' anxiety about paying for college. Regardless of the cost issues, direct lending versus the regular loan programs, I do think that direct lending has the benefit of being easier to use.

Mr. GLADIEUX. My only comment reinforces what has been said: Let the competition continue between direct loans and the guaranteed loan system. Competition has been good for students, good for institutions. Some institutions find one program better than the other. It probably will take a number of more years to see which is ultimately better, but for now, competition is good for students and I think good for the student loan industry.

Mrs. THURMAN. Mr. Breneman.

Mr. BRENEMAN. Well, I'm a big fan of direct lending, but I also think, to the point of middle and upper income families, what you're dealing with is not a decision, for the most part, on whether their child will go to college; it's where and how will they finance it. I think properly designed loan programs, such as I think we have in place, go a long way toward answering that financing problem, which is part of the reason why I tend to see the tax proposals as sort of deadweight losses.

Mr. HULSHOF [presiding]. Anything further?

Mrs. THURMAN. I do, but I'll wait.

Mr. HULSHOF. Mr. Jefferson, if you don't mind, I've got some questions to follow up.

I think, Mr. Breneman, you touched on this a little bit before.

When Secretary Rubin was here on February 11—and I think, if you were here, with questions earlier, he indicated the administrative costs of the paperwork associated with the $1,500 credit, the B-minus average, that he indicated there would be no administrative cost—or, as I think he put it, it would be the cost of a pencil. I think this morning we heard from panelists that it would be a "de minimis" additional cost.

I take it from your previous statements that that's not an opinion that you share.

Mr. BRENEMAN. Well, I'm trying to figure out where I ever said anything about administrative costs. That happens to be something on which I don't have any particular point of view.

Mr. HULSHOF. What we're talking about is the potential pressure on tuition inflation by these credits or deductions. I don't know that anyone is taking a look at what costs might be pushed on to the colleges and universities.

Has there been any study about the additional costs that must be borne by colleges and universities if these proposals pushed by the administration actually go into effect?

Mr. BRENEMAN. Let me try to clarify something, because I think the former Chairman got the administrative cost issue in with the tuition inflation issue. I at least would like to try to separate those. I don't have a particular knowledge base on the administrative issue, which some of my colleagues may.

I was simply pointing out that if there is another resource available to finance college in the form of either a credit or deduction, that the colleges know about, they will have a tendency to want to capture that themselves.

I used the example of the student aid vehicle. If I'm a student from a $60,000 family and I'm going to be eligible for $2,000 in tax benefits somehow, and I also apply for financial aid to a college that gives a fair amount of its own aid through discounting, and I'm a financial aid officer in that college, I'm not going to ignore

the fact that that family is now about $2,000 in benefits explicitly because the student is coming to college and, to some degree—maybe not a hundred percent—and in my testimony I treated it as a hundred percent—but to some degree, I'm going to offset my own aid against the benefit that that family now has, just as I would do with any other external form of aid available to a student.

That's a mechanism that doesn't have anything to do with administrative costs. It's just saying that somebody has got the money on the stump and I'm going to try to capture it before I do my own aid.

Mr. HULSHOF. Dr. McPherson.

Mr. MCPHERSON. If I could say a bit more about administrative costs, I don't think that the administrative costs would be large enough to have a discernable impact on cost levels at colleges or on tuition levels. They would be significant enough to make the wives of registrars and business officers and so on even more harried than they are now.

I also worry that this B-minus requirement will either be administered carefully, in which case it will be expensive and difficult both for the Department and for the colleges, or not carefully, in which case I'm afraid down the line we're going to find people feeling they're treated unfairly or feeling that there's abuse in the system.

I don't think anybody has come forward with a good rationale for the requirement in the first place. Why don't we want to help people who get C-pluses?

Mr. HULSHOF. Mr. Gladieux, let me ask you, from your testimony and your statement and publications, op-ed pieces that you've done—you mentioned that you support increasing Pell grants, but that we're even behind the curve as far as the purchasing power of the Pell grant.

Could you elaborate on that just a little bit for me?

Mr. GLADIEUX. We are way behind the curve. The purchasing power of the maximum Pell grant has eroded 30 to 35 percent in the past decade and a half so we need to make up for lost ground.

The increase that Congress voted at the end of the last session helps a lot and brings it up from 24-something to $2,700 in the next academic year. The following academic year, 1998–99, it would go to $3,000 under the President's plan, and that's definitely in the right direction. But as I said in my testimony, it doesn't stack up against a $1,500 tax credit and the potential value of a $10,000 tax deduction, which could mean as much as $2,800 or $3,100 in tax savings, depending upon the marginal tax rate of the taxpayer.

Mr. HULSHOF. Let me follow up with this, Mr. Gladieux. If this were an ideal world, and if you had your druthers, regarding Pell grants and the purchasing power of the Pell grant, what amount are we talking as far as bringing it up to where you think it should be?

Mr. GLADIEUX. You would have to bring it up close to $5,000. The value of the Pell grant peaked in the late seventies, and I think to get back there, it would have to approach $5,000 today.

That, in fact, is what Senator Wellstone's bill would do, and I think Representative McGovern in the House has introduced a

similar bill that would take the full estimated cost of the President's tuition tax proposal and redirect it to Pell grants. In his bill, the estimate is that that would get us up to a $5,000 maximum Pell. I think that's what we should be looking at.

I'm not sure that's going to happen right away or in the next few years, but we ought to be pushing in that direction.

Mr. HULSHOF. If I'm not mistaken, I think I just heard a cheer go up, from sea to shining sea, on college campuses, as a result of your answer.

My last question is to any of you on the panel. Yesterday, while we had our oversight hearing, I had 24 students from the University of Missouri system who came to talk about just this issue, about direct loans, about the Felt program, Pell grants, and all measures of aid and work study. There was a point made and a question, quite frankly, that I will put to the five of you.

What about the nontraditional student? Do the administration's proposals help the nontraditional student? And by that, I will just give you a couple of examples that were shared with me.

The 19- or 20-year-old young woman who chooses to be emancipated from her parents and who wants to try to pay her own way through school, or maybe the young married couple, particularly the young man who is going to be a freshman, who works part time at Shakeys Pizza back in Columbia, Missouri, but still pulls a full caseload of 15 hours per semester. He's taking a quick look at this, and the $10,000 deduction isn't going to help him. He's not going to qualify for a Pell grant because he makes enough money from his part-time job, and at the same time, the $1,500 credit is not going to be available to him, either.

Is this a situation where we're allowing a significant portion of students to fall through the cracks? Mr. Gladieux, you're nodding in assent.

Mr. GLADIEUX. I'm glad you asked the question, because I think we need to recognize in all this that well over half of postsecondary students today are deemed to be independent, self-supporting, not relying on their parents for financial support. Most of those students, at least a third in the data that I've seen, have incomes of less than $10,000. I have roughly calculated that about half have less than $20,000 annual income.

In the administration's own illustrative examples of who would benefit at different income levels, the benefit from the tax credit or the deduction will be zero at those levels. A majority of students attending public institutions are just trying to make ends meet. They're older students who have been working and want to come back and upgrade their skills or their job position. Many of them do not have taxable income or tax liability, against which they could apply these tax breaks.

So I think it will miss a large number of students, particularly in the community colleges. That's where the President's program has been held out as a great hope for making access universal. I just don't think the mechanism is going to do that.

Mr. KANE. There's one exception, though, and that is for single independent students. I don't think any of the students you mentioned would benefit, but for those students out there who are over age 24, who are still single and have no dependents, the adminis-

tration's proposal would let them protect more of their income before it's implicitly taxed away by the needs analysis system. Somebody can earn up to $9,000 under the administration plan before—that is for a single independent student—before that money starts to get counted against their Pell grant eligibility.

That $9,000 figure would be up from $3,000 today. What Larry is saying is right. Most independent students wouldn't benefit, unless they're already receiving a Pell grant, where they would get $300 more. But there are some independent students that would benefit considerably.

Mr. GLADIEUX. I think that's true. That highlights the point. The tax breaks really will not benefit these nontraditional older students. The administration has proposed a change to the Pell grant program for single independent students that would be constructive. That's part of their package. We applaud the Pell grant enhancements. They will help and the tax benefits will be much less valuable.

Mr. HULSHOF. Mr. Jefferson.

Mr. JEFFERSON. Thank you.

Professor Breneman, you say that institutions that have significant institutional aid packages, as a result of the Hope scholarships and tax deductions, will adjust their own aid downward; but you advocate an increase in Pell grants as a way to get around that problem.

How is it less true that if an institution has a significant institutional aid package that it will not also adjust their package downward if you have a Pell grant increase introduced?

Mr. BRENEMAN. Well, I think they probably will to some extent. If you had a significant jump, a $4,000–$5,000 Pell grant, in some cases—you know, I would have to think through the mathematics of each of these cases—but certainly that would be an aid to a number of colleges who are trying to fill the need that remains after existing aid and, in this climate, wind up having to do that with their own, basically, in most cases, discounting. They're just giving the student a reduced tuition, a reduced net tuition.

But the difference, I think, is that the Pell grant mechanism puts that money into the hands of students, number one, who might in some cases not even be in college without it, so many of the beneficiaries of the less targeted program are going to be there one way or another.

Mr. JEFFERSON. I certainly wouldn't argue against Pell grants. I was simply trying to understand how in the one case there's an adjustment downward and in another case there would not be, just to meet that institutional aid argument that you mentioned.

You also, of course, mentioned two or three other things in here that don't deal with that particular concern. But if I understand you, universities could make an adjustment in either event, depending upon the size of the Pell grant award, and that taken into account to reduce institutional aid.

Now, you say also that for those schools that don't give much in an aid package institutionally, that it might cause an increase in tuition; otherwise, they can't benefit from the packages here. I guess in this case, are you saying the Pell grant operates dif-

ferently with respect to these schools? I guess, if you increase it substantially, won't there still be a tendency to raise tuition?

Mr. BRENEMAN. Actually, I think not in quite the same way. The Pell grant is an income-tested program, and there are few cases of very low tuition institutions where it's possible that an increased Pell grant, if they raise their tuition, would actually raise the eligibility of the students. But, generally speaking, I think most of us who have looked at this issue—in my case, while I was at Kalamazoo College, an increase in the Pell grant, if I raise my tuition, I didn't get three cents more from the Pell grant because it was capped out by an income test and not by a cost-of-college test.

Whereas, with the tax credit, in principle, if a very high percentage of your student body is covered by it, you have a much higher chance to capture something.

Mr. JEFFERSON. It would probably depend on how low the tuition is to begin with, as to whether it would be affected at all.

Mr. BRENEMAN. Right.

Mr. JEFFERSON. The last thing you talk about is the shifting of costs from State to Federal. Here again, I'm trying to see the distinction between these two aid programs.

What the administration is apparently trying to say—and I'm not sure how well it's saying it—is that some of these benefits are designed to assist certain income groups and certain other benefits which may not be before this Committee, which may not have anything to do with the Tax Code, but may be in the Pell grant area, are designed to reach other students from other income groups. And when you put it all together, a whole lot of folks get helped.

This last point you make here about the shifting, tell me how you differentiate—how the differentiation is made between State and Federal cost shifting, whether it is a tax credit or a grant.

Mr. BRENEMAN. Or a Pell grant?

Mr. JEFFERSON. Yes.

Mr. BRENEMAN. Well, once again, I think the Pell grants are a targeted grant, which is probably ultimately going to cover a smaller proportion of the students in a study body. I mean, to some degree, particularly when you get into the 4-year public institutions that don't have the student aid mechanism to play with, you're now into a politically determined price tuition. Tuition is not something that most public campuses set arbitrarily. They have to negotiate it with the Governor, the legislature, and so on.

I think the difference might come in that the tax proposals are more broad-based and cover a higher percentage of the study body, so that if you were to push tuition up, you would sort of be taking across from the entire student body.

Pell grants are still, even in the versions we've been talking about, higher levels, would still be covering a smaller fraction of the student body, so to be blunt about it, you would have a certain number of parents in the, say, $60,000 range, that would be resistant, I think, to tuition increases simply because Pell grants have been raised, because they aren't necessarily going to benefit from that. Whereas in the other case——

Mr. JEFFERSON. Mr. Chairman, may I ask one last thing here?

Chairman ARCHER [presiding]. Certainly.

Mr. JEFFERSON. The administration has made the argument that the $1,500 tax credit is designed to assist people going to community colleges, maybe folks who are already working, who want to add some more formal education requirements, maybe for a job switch in the middle of their careers or whatever.

Does this make any sense to you as a way to address that issue, where you have people out there earning money, who are looking to change job skills or moving to different careers? Does it make any sense to you that this can work in that regard?

Mr. BRENEMAN. The tax credit?

Mr. JEFFERSON. Yes, with respect to someone who is already working, already in the workplace, looking for a change in career, maybe just wanting to move up in his job or move up in some other career opportunity, and who is able to go back to school with this particular assistance.

Mr. GLADIEUX. I would be glad to start by using an example from California. Students going to community colleges in California I do not believe will derive any value, any relief from the tax credit.

I can't tell you exactly the tuition level now, but it is well below $1,500. Tuition in California for community colleges, public 2-year institutions, is minimal, a couple hundred dollars, in that range. It used to be zero. Fees were introduced for credit hours within the last few years. There will be no benefit to community college students in California.

As I said before, I am concerned about the nontraditional students who are trying to go back for a second or third chance and upgrade their situation, and are just making ends meet. They may have had a job where they had some significant income, but now they're just trying to get by financially while going to school. I don't think they're going to benefit from the tax credit.

So it has been advanced as something that will make the 13th and 14th years universal or free, and I think it's going to fall well short of that.

Mr. SCHAPIRO. I think the stipulation in the bill, where it mandates the offset between the Pell and any additional credit anybody would get, any additional money, pretty much makes sure that the number of people who presently cannot afford community college, who would now be able to afford it, is held to a minimum.

If I could just get back to your question before, I think it was an excellent question. What's going to happen if you increase the Pell grant? Is it going to have an effect on causing individual institutions to cut their own aid, and then is it going to induce these schools to increase tuition even more than otherwise, because I think everybody would agree that it's an empirical question. In fact, Mike McPherson and I, in a book we published in 1991, looked at that in great detail.

Let me just take a second to say what we found. We found that, for private, 4-year colleges, in fact, not only did increases in Pell not translate into a retrenchment, in terms of financial aid, it was actually an enhancement of financial aid. In other words, they were complements rather than substitutes.

What happened was—and this was over the period 1978 to 1985—what happened was the expansion of Federal and State financial aid during that period enabled a number of low-income stu-

dents to enter into the world of private education, where they previously weren't able to. And then the individual private institutions took up the slack in making it affordable for them. So, in fact, we didn't find substitutability; we found complementarity.

The other question, about is it going to be an inducement to raise tuition, is a little more complicated. We found in this same study that for private, 4-year colleges and universities, in fact, there was no statistically significant relationship between changes in the Pell grant and the tuition that they charged.

On the other hand, for public, 4-year colleges, we found a very strong, positive relationship. In other words, over that period, when the Pell grant went up more rapidly, 4-year publics increased their tuition more rapidly than they otherwise would have. At least that's what we found.

Chairman ARCHER. The gentleman's time has expired.

Let me apologize to all five of you gentlemen that I've not been able to be here for all of your testimony. Unfortunately, there are other duties that arise where you have to make decisions. But I am glad that I've heard a great deal of it and would like to ask a few questions of you, if I may.

Why are the costs of college so much more expensive today than they were 20 years ago? Why have they so greatly exceeded the rate of inflation?

Mr. KANE. The answer to that question depends upon which type of institution it is. At public institutions, we should make a distinction between cost per student and tuition. If you look over time, cost per student at publics have been rising faster than inflation, but not 70 percent faster than inflation; more like 20 percent faster than inflation, cumulatively over the last 15 years. In the face of increases in enrollments and other demands on State budgets, States have been unable to continue to pay the same share of the costs that they used to before. The share of costs covered by State subsidies has declined and that's a big part of the reason for the increases in tuition at public colleges.

At privates, the story is a little bit more complicated, because if you look over time, their sticker prices have shot up even faster than publics, at about 80 percent. But there's good news and bad news. The good news is that at privates, with a lot of institutional aid, net prices have not risen nearly as quickly as tuition. It has risen more on the order of 40 percent or so. That's the good news.

The bad new is, though, costs per student have also increase by about 40 percent about twice as fast as at public institutions. So the cost per student increases have been faster at the privates than they have been at the publics. To summarize, in publics, most of the tuition increase has not been a cost increase; it's been a change in the State subsidy. At privates, the tuition increase exaggerates the actual cost increase, but the cost increases were bigger at the privates than they were at the publics.

Chairman ARCHER. Again, in the private schools, why does the tuition increase rise faster than the cost?

Mr. KANE. Well, they're doing more institutional aid. They're raising the sticker price but charging different students different rates. The highest income students are probably paying something closer to the sticker price.

Chairman ARCHER. Is that so they can more greatly subsidize the low-income students and create more scholarships?

Mr. KANE. It's hard to sort out exactly what's been causing it, but it may very well be that because the Pell grant maximum, the Federal grant, has declined in real value over time. Some of the privates have been picking up that slack with their own institutional aid.

Chairman ARCHER. So you have, in effect, more in the private institutions, a cost shifting, like you have in health care? Is it a comparable type of thing that's occurring?

Mr. KANE. I suspect that's part of the story. But there has also been a change in merit aid, which other people could comment on.

Mr. SCHAPIRO. One way to answer that question is to say where is the money going. You can point to the revolution in technology and all the costs that that entails, and some would say the increase in government regulation I should add. Whether these sorts of stipulations increase costs or not, it's not going to stop college presidents from blaming it when they increase their tuition. I'm glad my colleague is laughing here.

As an economist—and we're all economists here—one way is to look at where we're spending the money. The other side is to say how could they get away with increasing their costs? I mean, there is a lot of good things that colleges and universities have spent their money on over the last 15 years. But I can say that if the market didn't support these extraordinarily high increases in tuition, they wouldn't have done it. We can point to, as we did in our testimony, and Tom did as well, that enrollment rates are at record levels. People are willing to pay for it. Why? Because the rate of return to higher education is at a record level.

So you can look at the more recent increases in tuition and they're no longer 4½ percent real. They're now 2½ percent real. Is it because people have all of a sudden been scared by jawboning from the president, and is it because they ran out of good things to spend their money on? The answer is no. They're hitting a price wall. Over and over again, more and more schools are now finding the long lines of no-need and low-need students that used to be knocking on their door, they're gone. Now all of a sudden they're responding. Not that they don't have great things to spend their money on, but all of a sudden the market isn't strong enough and the demand isn't strong enough to sustain those kinds of real increases.

So again, I would point to the fact that people are willing to pay it and that's why they increase their tuition, and now they're not willing to pay it, which is why we're getting much closer to an inflationary increase in tuitions.

Chairman ARCHER. Let me follow up. If I heard you correctly, the applications for enrollment are at an all-time high——

Mr. SCHAPIRO. The enrollment rate.

Chairman ARCHER [continuing]. And yet you say they're dropping off and, therefore, there is a price war. Did I misread something?

Mr. SCHAPIRO. What we're starting to see is a real shakeout in the higher education industry. The number of schools that are really elite, especially in the private sector, who could basically charge whatever they wanted and people were willing to pay it, you know,

that is really dwindling. It has dwindled a lot over the last two decades.

The enrollment rate is still at record levels, but increasingly, certain groups of institutions are starting to find themselves in a much more competitive situation. Their response, of course, as in producing any consumer product, is that when you find that your competitive niche becomes eroded, then you start to moderate your price increase.

Chairman ARCHER. Mr. Breneman.

Mr. BRENEMAN. Well, I think another spin on that is that the colleges and universities are not quantity adjusters. You know, we all build a plant and have a faculty and want to enroll a certain number of students. So one of the results of high price increases over the last 10 to 15 years, as Morty indicated, is that in the private sector, a growing number of colleges simply can't fill up, can't hit their enrollment targets, at the posted price they're charging. So the number of full-pay students has been declining. What the colleges have been doing is working right down the demand curve, not unlike airlines. This is sort of like ticket prices, sort of the economics of fixed capacity. You've got a certain number of students you want and you've got 30 percent who will pay the full price, and then you start working down with student aid and charge less and less to the students who can't or won't pay the higher price, until you reach the level you want to get to.

Chairman ARCHER. When you're doing that, though, do you then cost shift to the people who are able to pay a higher price? You're not actually reducing your costs of education but you're just shifting the——

Mr. BRENEMAN. Well, to some extent you are doing that. I think it's a little more complicated because there are other sources of revenue coming into the school. You have endowment income. But to some degree you are taking everything you can get from every source and trying to put it together and balance your budget.

I will have to admit, as a former president who used to write these tuition letters, it looks, to full-pay parents, like part of their payment is, in fact, going to subsidize the students in the class who are lower pay.

On the other hand, virtually nobody is paying the full price. There is a subsidy level from other sources in any case and you have to argue that you want a diverse student body and so on. It's an issue, though, that I think is a very real one for most college presidents these days.

Chairman ARCHER. Clearly, from your responses, it is a pretty complex issue. But I do wonder if the Clinton proposals will now, in effect, ease some of the pressure on those who are paying the higher cost and, as a result, accommodate, in an overall sense, the continued buildup in average costs which have to be paid for some way or another.

In other words, the true costs. I'm not talking about the bills you send out. I'm talking about the costs you've got to cover. We need to distinguish those two. When we talk about costs sometimes, we use them interchangeably, and that's unfortunate.

But to be more productive and more efficient, which I'm proud to tell you this Committee has done in the last Congress, because

we reduced the cost of operating this Committee by 40 percent when we took over, and we turned out more legislation, more quality legislation, spending 40 percent less. That's not relative to a baseline inflationary increase. That's relative to what was spent the previous year.

Are any of those pressures being felt in colleges and universities, that we've got to produce more and we have to do it more efficiently with less, or is it kind of "well, we'll find a way to cost shift and we'll adjust these things and we don't feel any pressure to be more efficient"?

Mr. MCPHERSON. If I could, Mr. Chairman—I'm a private college president, but I would like to say a word on behalf of public colleges and universities, because a lot of those places really have been squeezed, as Professor Kane said.

States have withdrawn quite a lot of support. In fact, in real terms, the decline in State support for public higher education is about equal to the dollar amounts that are involved in these proposals. So these places, in many States, have had real declines in spending, and have had tuition increases that don't even make up for those declines. So they have had serious experience with having to fight with really reduced budgets.

Unfortunately, the way State budgeting tends to work, there aren't very good incentives to be productive in that case, because you sort of get the "Washington Monument" phenomenon. You certainly don't want to try to save and advance, because if you save and advance, the legislature will take it all away. So it's hard to do good forward planning in that environment.

But the pressures really are out there.

Chairman ARCHER. When I was in the Texas legislature on the Appropriations Committee, we went through a lot of that very thing with our State-supported universities.

Mr. MCPHERSON. And I think some States are now thinking pretty hard about budgeting systems that will reward schools for being more efficient, rather than simply trying to get across-the-board cuts.

Chairman ARCHER. I appreciate all that wonderful background information, and I want to try to tie it into the Clinton proposals and what we're about right now.

Would you say there is at least a degree of softening the edge of cost shifting if this proposal were adopted for the Hope scholarship or the tax benefits for higher education? I mean, you have said that at least some degree of what's occurring is cost shifting to people who can afford to pay.

Now, if it were put into effect, this would certainly impact beneficially those people who are in a better category of being able to pay. Would that, to some degree, soften the edge of the cost shifting?

Mr. KANE. I could comment on that a little bit.

If I were an institution charging $10,000 now, if I tried to raise my sticker price to $11,000, even for the families taking the tax deduction or taking the tax credit, they're paying 100 percent of that thousand dollar increase.

Now, if I'm Harvard College, or I'm another college that has some market power, I might still be able to capture some of that.

But if I am Kalamazoo College, competing with Macalester, I might love to be able to try and capture some of that tax credit or the tax deduction. But to the extent that I have now become a thousand dollars more expensive relative to my competitors, I might find that I am not able to get away with it.

On the other hand, if I'm providing a "free ride" to some low-income students, the way the proposal is written, it implicitly taxes at 100 percent any institutional aid that I give to that student beyond a certain amount. Because the student's tax reduction is being reduced for any institutional aid that they get, some of that money is being taxed away, so maybe I will do less cost shifting, as you say, than I was doing before.

Chairman ARCHER. I appreciate that. But I still must say—and I think all of you, as economists, would agree with this—that it gets back to the law of supply and demand. Certainly, to some degree, you're going to increase the amount of demand through these tax arrangements. I mean, to some degree. We can argue about the magnitude of it. And to the degree you increase the demand, you're going to have some pressure on inflating the cost of education, or the price of education.

Mr. KANE. But as economists say, it's mostly an income effect rather than a price effect.

Chairman ARCHER. So it's a question of the magnitude. It may be very small, you're saying.

Mr. KANE. Yes. Families will take that tax relief and spend some of it on higher education, and they will also spend some of it elsewhere.

Chairman ARCHER. Yes. I don't want to get into a broad-based economic discussion here. I fully understand.

Mr. KANE. I couldn't help it. I've been teaching this semester.

Chairman ARCHER. What percent of our total educational dollars are being spent on higher education, postsecondary education, in the United States? Do any of you know that offhand?

Mr. GLADIEUX. Expenditure on the industry is roughly $150–$175 billion now. Elementary and secondary, K through 12, is probably $300 billion.

Mr. BRENEMAN. Higher education is about 3 percent of GDP, and I think K through 12 is about 7 or 8, maybe 8 percent. Does that sound about right? So it would be a factor of two to one, maybe.

Chairman ARCHER. So about one-third is being spent on postsecondary education. How does that compare to other nations in the world?

Mr. GLADIEUX. A much bigger proportionate investment, I think, than most other countries in the world.

Chairman ARCHER. I'm sure it is bigger, but do you have any idea to what magnitude?

Mr. MCPHERSON. I think you would find big variations. In particular——

Chairman ARCHER. Let's say Western Europe, where I think there's probably a great similarity between the countries.

Mr. MCPHERSON. In Western Europe—and I'm really going on a kind of "seat-of-the-pants" sense of magnitudes—I think Western Europe would not look so dissimilar from the United States.

If you look among developing countries, there are real differences in strategies. Some countries have invested very heavily in widespread elementary education and have actually had great success. Others have invested much less in that and much more in——

Chairman ARCHER. I'm really thinking of developed countries like Western Europe and Japan, to try to draw a comparison. I still have to believe, just off the top of my head, that we spend far, far more than they do in either Japan or Western Europe, and I was going to ask you this question:

What percent of our high school graduates are educated in higher education in this country compared to Western Europe?

Mr. BRENEMAN. Well, the participation rate in the United States is 60 percent or more of high school graduates that begin, and it is much lower—I don't know, 20 percent maybe, in—it depends on different countries.

Mr. SCHAPIRO. Twenty to forty, normally.

Mr. BRENEMAN. Their strategy has typically been to admit a much smaller share and then pay the full cost.

Chairman ARCHER. Exactly.

Mr. BRENEMAN. Our strategy has been to admit a much bigger share and then work all these incredibly difficult cost-sharing arrangements.

Mr. KANE. Although to some extent their institutions are different. They also do more training——

Chairman ARCHER. What additional percent of our high school graduates should go to college in the United States for the greatest benefit of our society as a whole?

Mr. KANE. I don't think anybody knows what the target would be, but there's not much sign that, despite recent increases in enrollments, the value of a college degree is falling. In fact, if anything, the value of a college degree has risen. It has leveled off some, but if it were that we were at the point where we had too many people going to college, we ought to expect to see prices start to fall again, and there has not been much sign of that.

Eventually, I suspect that is going to happen, but it has not happened yet.

Mr. SCHAPIRO. Just to add also. The proportion of low-income students, students from low-income families who are going on to American higher education is much too low.

In fact there have been a variety of enrollment studies controlling for academic talent, and they found the following. That a highly talented student from a low-income family is decided less likely to get any form of postsecondary education than a marginally talented student from a very affluent family. And that has not changed in 30 years.

Chairman ARCHER. But if we are educating—and I do not want to belabor this—if we are educating such a higher percentage of our high school graduates in college than our major competitors in Japan and West Europe, you have to wonder how much of an additional percentage of high school graduates should go to college. It is, clearly, clearly, much, much more expensive than elementary and secondary education.

It seems to me that this is not the Committee to try to determine all of this, but it is a basic question that has to be asked at some point.

I have really taken too much time and I apologize to my two colleagues who have sat through all of this inquiry.

Unless either one of them has a followup, you gentlemen have been very patient and very helpful.

Thank you so much, and we will go on to our next panel. Thank you.

Mr. HULSHOF [presiding]. Good afternoon, gentlemen. We welcome you to the Ways and Means hearing room and this Committee, and appreciate very much your patience as the hour is long, and you have been patiently waiting. We appreciate that greatly.

We will submit, for the record, your written statements, and welcome each of you now to provide whatever oral testimony you wish to the Committee.

Mr. Ikenberry, would you like to begin?

STATEMENT OF STANLEY O. IKENBERRY, PRESIDENT, AMERICAN COUNCIL ON EDUCATION

Mr. IKENBERRY. Thank you, Mr. Chairman.

It is a pleasure, even though we are a bit delayed, it is a pleasure for all of us to be with you and we appreciate the opportunity.

I have submitted a more detailed statement for the record, and if I could, I would just like to make two or three points.

The first, is a point that I am sure the Members of the Committee have heard repeatedly, and it really relates to the importance of higher education as an investment in the Nation's future—important not just to the economic health of our society, but also to the ability of individual citizens, if you will, to pursue the American dream.

We have before us many proposals to expand the use of the Tax Code to help individuals pay for higher education, and there are several of these that are not necessarily the special focus of the deliberations of this Committee today but I think deserve notice in the sense that they have broad bipartisan support on Capitol Hill.

For example, the proposal to expand the flexible use of IRAs, the deductibility of student loan interest, the making of section 127 employer-provided educational benefits permanent, and so forth.

These would help different groups of individuals in different ways. Some would help families, some would help students in terms of their loan interest deduction. And some would help adults in terms of providing continuing learning.

But the total impact we believe would have a very significant impact on improving the accessibility and the affordability of higher education.

Let me focus just for a second on President Clinton's specific proposal for Hope scholarships and a tax deduction.

We think these represent a very significant expansion of the Federal Tax Code for higher education and a beneficial one, modeled in part after a very successful program in Georgia.

I had the opportunity to visit with my colleagues in Georgia, both from the University of Georgia, and other institutions, and from State government there. The reports on the impact of this program

in Georgia were very positive. It has, in fact, increased access to higher education in Georgia, particularly in the community college sector.

Incoming students are better prepared, low-income families have increased access to, and interest in, higher education, and in terms of the unintended, or feared negative consequences, in fact, in Georgia, tuitions have not increased faster than the national average, nor has grade inflation in the case of Georgia been a problem.

I think, however, as we look at the Hope scholarship proposal and at the tax proposals, it is crucial, as the other witnesses said on the earlier panel, that the President's tax plans are coupled with a very significant expansion of the Pell grant program for low-income students.

Taken together, this total package could have a very positive impact on lower and middle-income families' ability to finance higher education.

The American Council on Education supports the President's proposal and a board resolution to that effect is attached to my testimony.

We do have two concerns in regard to the proposal. One is that it should be easy for students and parents to comprehend and understand, and it should be directed to benefit those who need it most.

We look forward to the opportunity to work with Congress and with the administration to address these particular issues.

For example, we believe the President's proposals should be revised to make sure that low-income families in fact do receive a fair share of the benefits of these proposals. At present, the award rules would sharply reduce or eliminate the benefits of the Hope scholarship for anyone who received a Pell grant, a State grant, or even an institutional grant or private scholarship.

We believe the proposal ought to be revised, so that those who get student aid from these other sources would also be eligible to participate in the Hope scholarship, or tax credit.

Second, the use of the B average to determine eligibility for the tax credit in the second year of enrollment in college, we believe creates a level of uncertainty for students and families as well as an administrative burden for colleges.

The student will not know if they will be eligible for the tax credit in the second year or not, and will therefore have uncertainty. Student grades, furthermore, are confidential personal records that should not be used in the Tax Code.

The administrative burden has been spoken to earlier and I will not repeat that, but we believe it would be significant.

So, in closing, we believe this is a positive proposal. We do not believe that it would increase the cost of college. In fact the evidence that we do have suggests that increased Federal student aid in fact moderates increases in tuition and fee cost. It does not contribute to them.

My own experience as president of the University of Illinois for 16 years also corroborates that. It was in cases in which we were having to make up for deficiencies in Federal or State aid, where tuition and fee costs were pressed upward.

Mr. Chairman, I appreciate this opportunity. I will conclude my testimony now, but would look forward to the opportunity to respond to any questions.

[The prepared statement and attachments follow:]

Statement of Stanley O. Ikenberry, President, American Council on Education

Mr. Chairman, and members of the committee, I am Stanley Ikenberry, president of the American Council on Education (ACE.) ACE is the nation's principal, independent nonprofit coordinating body for postsecondary education, representing 1,689 two- and four-year public and private colleges, research universities, and national and regional education associations. The views I am presenting today have been endorsed by the 13 higher education associations listed on the cover page.

I am pleased to have an opportunity to appear before you today as the committee begins to examine the desirability of broadening the tax code to make college more affordable for American families. The higher education community welcomes the interest that has been expressed in this subject by the Congress and the Administration. We believe the time is right to explore these issues, and we hope to work closely with you to fashion sound public policy that will complement the existing federal student aid programs and will yield real benefit to students and their families.

There is little doubt that properly crafted tax assistance will be favorably regarded by the American public. During the 104th Congress, ACE and more than 40 other national associations formed the Alliance to Save Student Aid. As background for its efforts, the Alliance sought to measure public opinion on federal student aid. To that end, KRC Research & Consulting, Inc. conducted extensive interviews with 1,000 American adults over a two day period. The survey results provided overwhelming evidence that Americans of all political persuasions support federal spending on programs that help students go to college. Respondents ranked continued funding for student aid alongside Social Security as a top national priority, with particularly strong backing for this view from the middle class. Among respondents with family incomes between $25,000 and $60,000, fully 92 percent said it was important that the federal government maintain programs that help college students. Furthermore, agreement was high that "tax dollars allocated for student aid programs is money well-spent." Eighty-six percent concurred with that statement, including 85 percent of conservatives and the same share of Republicans. Agreement among middle-income voters ranged from 85 percent to 91 percent.

The Congress responded to these concerns last year by increasing funding for the Pell Grant program by $1 billion, elevating the maximum award level to $2700, and by boosting the work-study appropriation by 35 percent to $830 million. We are grateful for these increases, and we strongly support the President's FY 1998 budget request of an additional $1.7 billion for the Pell Grant program, and an additional $27 million for the work-study program. However, although our members will work diligently to persuade Congress to adopt these recommended funding increases, we are skeptical about the ability of discretionary appropriations to keep pace with the demand for substantial annual increases in student financial assistance programs on a sustained, long-term basis. Pressure already is mounting for significant reductions in annual discretionary spending as Congress makes progress toward deficit elimination, and the pressure is being felt acutely by the Labor-HHS-Education Appropriations Subcommittee, where so many of the nation's domestic priority programs reside.

Even absent the intense pressure of disciplined deficit reduction, the spotty appropriations history of the Pell Grant program fuels our anxiety about the unlikelihood of sustainable future funding increases. The maximum Pell Grant award was set at $2300 in FY 1989, and again in FY 1990. In FY 1991, it was increased to $2400, and was held steady at $2400 in FY 1992. It was decreased to $2300 in FY 1993, where it remained in FY 1994. In FY 1995, it was increased by only $50—scarcely enough to pay for one text book. Overall, between FY 1979 and FY 1995, before it began its rise to the present level, the Pell Grant maximum award had declined by more than 30 percent in real terms. Appropriations for the campus-based student aid programs and the State Student Incentive Grant program have been equally discouraging when measured in real dollar terms.

What is the point of inserting these trend lines into this testimony? The answer is quite simple. The unevenness and unpredictability of federal need-based student aid appropriations has contributed to an unhealthy reliance on increased debt financing of college costs. This, in turn, has led many members of Congress, the President, and members of the academic community to consider whether appropriate use might be made of tax incentives to supplement the existing array of stu-

dent aid programs, particularly to alleviate the financing burdens of the middle-class who are served somewhat less well by the need-based programs, and are substantially more reliant on borrowing. Consequently, we believe that one of the most attractive features of the President's proposals is his recognition of the need for tax remedies to coexist in tandem with a robust discretionary student aid allocation.

In regard to the examination of the President's proposals by this committee, I would like to make five points for your consideration:

1. *Increased investment in higher education is warranted*. Access to higher education is vitally important for the nation's long-term economic growth and social progress. Throughout this century, increases in the educational attainment of the workforce accounted for 27 percent of growth in the nation's wealth. Advances in knowledge (better education, research, new technologies, and improved managerial and organizational know-how) accounted for 55 percent. To compete in the global marketplace, the nation needs a well trained and educated workforce. The Department of Labor predicts that, by 2005, the number of jobs requiring an MA, BA, or AA each will jump by one quarter. Our colleges train the skilled and flexible workers that American businesses needs.

The acquisition of a college education provides tangible benefits to individuals as well. Each year, colleges and universities open the doors to a higher standard of living for millions of Americans. In homes with a college degree holder, average incomes are 75 percent higher than in homes with only a high school graduate. Between 1975 and 1992, the expected lifetime earnings of high school graduates barely kept pace with inflation. During this 18-year period, real wages rose above inflation only for those with a college degree. A by-product of this increased earning power is that those with educational attainment above the high school level are far likelier to be paying the highest marginal tax rates.

Finally, the nation relies on higher education for social progress as well. Educational attainment equates to lower unemployment, and fewer demands on the public purse for such needs as unemployment compensation and health care. And even more significantly, education is an engine of upward mobility. Since 1960, for example, the size of the African-American middle class has tripled—a development made possible by the increased access to higher education that federal education assistance has fostered; and more women than men have been enrolled in college every year since 1979, with commensurate growth in their economic clout.

2. *Many proposals that we strongly support, including several with bipartisan, bicameral sponsorship, have been introduced to expand the use of the tax code to help individuals pay for postsecondary education*. The proposals we support that have garnered bipartisan and bicameral support include: an expanded flexibility to use Individual Retirement Accounts (IRAs) to meet college expenses; and the permanent exclusion of employer-provided education assistance from taxable income, including a reinstatement of graduate and professional student eligibility for this benefit (Section 127.) We are pleased that these proposals also are included in the President's package, but regret that Section 127 is extended only through the year 2000 in his plan.

Two variations of expanded IRAs have been advanced: enabling the use of funds held in the account to be withdrawn without penalty for college expenses; and allowing the establishment of dedicated education savings accounts for which the interest would accumulate on a tax-free basis, though the funds in the accounts would not be penalty-free. We would encourage the addition of 401(k) and 403(b) accumulations to these proposals.

Restoring the deductibility of student loan interest has been a higher education community priority for a decade. Before 1986, student borrowers could deduct interest paid on education loans from their adjusted gross income—assuming the sum total of their "below the line" deductions exceeded the standard deduction. If the deduction were made an "above the line" provision, numerous young men and women who have borrowed to finance their education could benefit upon entering repayment. As the average indebtedness of recent college graduates has increased, so has the potential value of this benefit.

The permanent extension of Section 127 is another long-standing priority of the higher education community. This provision has particular value in helping to upgrade the skills and abilities of American workers, including those pursuing graduate and professional credentials. By allowing this provision to lapse periodically, Congress has created a disincentive to employees to pursue continued education. We urge that Section 127 be extended permanently once and for all.

Other important tax proposals have been advanced by the President and/or members of Congress which also enjoy support from the higher education community. These include: allowing tax-free withdrawals from qualified state tuition plans; excluding from gross income any amounts received under the federal work-study pro-

gram, and granting assistance to independent colleges and universities by removing the cap on tax-exempt bond financing and making tax-free, university-based, loan forgiveness payments.

3. *When coupled with a significant expansion of the Pell Grant program, President Clinton's proposal to create Hope Scholarships and a $10,000 tax deduction will help students from low-income through middle-class families to afford a college education.* For these reasons, the ACE Board of Directors adopted a resolution endorsing the broad elements of the President's comprehensive plan, as well as one that speaks to other congressional proposals that have emerged. I have appended these resolutions to my statement.

While the President's proposal for America's Hope Scholarships differs in several significant ways from the Georgia Hope Scholarship after which it is modeled, and while more analysis of its impacts is needed, the Georgia experience still is instructive. I have been to Georgia to meet with officials from the state government and the University of Georgia, and have been informed by them that the program has produced profoundly beneficial results. Many students have participated, including 95 percent of the first year students at the University of Georgia and Georgia Tech. Enrollment has increased. For example, community college enrollments are 40 percent higher over a four-year period. Incoming students are better prepared as evidenced by higher SAT scores, and the demand for remedial education is declining. In addition, there has been increased participation in higher education by lower income students, tuition has not climbed faster than the national average, and grade inflation has not been experienced. I would call your attention to a statement attached to my testimony from Dr. Charles Knapp, president of the University of Georgia that addresses these points in more detail.

The President's proposal also includes an above-the-line tax deduction of up to $5,000 (1997–98) and $10,000 (1999 and thereafter) for those students who are ineligible for or choose not to participate in the Hope Scholarship tax credit (e.g., because they have completed their second year of postsecondary education.) The deduction could be utilized by a much broader range of students—including part-time students taking courses to improve or acquire job skills. Like the credit, the deduction is targeted to middle-income taxpayers and phases our ratably for higher-income ranges ($80,000 to $100,000 for joint returns.) This proposal appropriately supplements other components of the President's package, and will encourage lifelong learning and retraining among adults, as well as academic persistence and degree attainment among younger students.

4. *There are aspects of the President's proposals that are not as well developed as they might be, and we hope to work with the Congress to refine and improve the proposals, especially as they relate to the treatment of students from low-income families.* Preliminary analysis indicates that low- and moderate-income families would derive significantly less benefit from the Hope Scholarship and tax deduction plans than was originally envisioned. The manner in which this proposal interacts with need-based assistance should be revised so as to inject more equity into the award rule formula. The proposed netting out of all federal and non-federal grant assistance has particularly harsh consequences for low-income students. Further, netting Hope eligibility against non-federal aid would provide a powerful incentive for states and private sponsors to curtail or eliminate their efforts. Finally, the decision to make this a non-refundable credit also renders it less helpful to lower-income families.

Another problem that exists with the Hope Scholarship, though not with the tax deduction, is the use of the "B" average to determine the second year of eligibility. The higher education community has serious concerns about this requirement for two reasons: first, the proposed requirement would breach the confidentiality of student records; and second, the potential administrative burden in verifying records this could impose on colleges, parents, and students could well prove to be enormously complicated and unworkable. ACE believes that student grades are confidential personal records which should not be subjected to open scrutiny for tax collection purposes. In addition, the nation's 3,500 colleges and universities each have idiosyncratic grading systems. Some do not award grades at all. Others do not grade on a 4.0 scale. For these reasons, we urge Congress to delete the "B" average requirement in favor of the "satisfactory academic progress" standard that is consistent with existing federal student aid statutes.

5. *The President's plans will not have several of the consequences that some of its critics have implied that it will have.* First, as I noted earlier, we hope the "B" average will not be included in any forthcoming tax legislation. However, since critics are asserting that this aspect of the Hope Scholarship proposal would negatively affect institutional grading policies, I would like to address this issue. We do not believe that its adoption would lead to grade inflation. Several facts support this contention. Foremost among them is the fact that colleges are more vigilant in this re-

gard than the public appreciates. In a May, 1995 New York Times article, Clifford Adelman, a senior research analyst from the Department of Education asserts that "Contrary to the widespread lamentations, grades actually declined slightly in the last two decades." Last week's Newsweek magazine cites the effort being made by Duke University to recalibrate and lower its grading system in response to a belief that too many of its students were receiving "A's"—a situation prompted by the increasing admission of students with higher SAT scores. The same article takes note of Stanford University's recent reinstatement of the "F" in its grading system.

On this topic, the Georgia experience also is relevant. After four years experience with the Georgia Hope scholarship, no evidence of grade inflation exists. In addition, half of the recipients do not make a "B" average, and as a result, forfeit the scholarship in the second year.

A second consequence that will not materialize is that tuition will rise faster because of the President's proposals. The data show that federal student aid is inversely related to tuition increases. That is to say that when federal student aid goes up, tuition increases are negligible. Repeated studies of the relationship between federal assistance and tuition increases have failed to establish a positive correlation between the two. (A table illustrating this point is attached to the statement.)

Here again, the Georgia experience is illustrative. Tuition at public and private colleges in Georgia have not risen under the Hope plan faster or higher than at other institutions throughout the nation. In my own experience based on my 16 years as president of the University of Illinois, many factors played a part in a decision to raise tuition: the views of the governor and the state legislature, how students would be affected, reaction by the media, and the needs of the library, the faculty, and the campus generally that would go unmet if we failed to increase tuition. Our goal was to constrain tuition, while maintaining quality. Federal student aid, unless it was sharply reduced and we had to compensate for lost revenues, was not a factor. Frankly, I believe the President's plan would have helped us in the effort to keep tuition increases to a minimum.

In conclusion, President Clinton and congressional leaders from both parties have proposed significant changes to federal tax laws that hold out the promise of providing needed assistance to help sustain and expand access to college. These proposals are diverse and wide ranging in their scope, and we believe that all of them are worthy of your attention. The President's package of initiatives and the legislation introduced in Congress make important linkages between their tax policy proposals and their enhancement of need-based federal student aid. We urge you to support this approach in the legislation that you develop. We are optimistic that bipartisan legislation can be enacted, and we commit ourselves to working with you toward that outcome.

This statement is on behalf of American Association of Community Colleges, American Association of Dental Schools, American Council on Education, Association of American Universities, Association of Community College Trustees, Association of Governing Boards of Universities and Colleges, Association of Jesuit Colleges and Universities, Council of Graduate Schools, Council of Independent Colleges, National Association of College and University Business Officers, National Association of Independent Colleges and Universities, National Association of State Universities and Land-Grant Colleges, and National Association of Student Financial Aid Administrators.

AMERICAN COUNCIL ON EDUCATION ATTACHMENT 1A

RESOLUTION BY THE BOARD OF DIRECTORS OF THE
AMERICAN COUNCIL ON EDUCATION
ON PRESIDENT CLINTON'S HIGHER EDUCATION INITIATIVES
FEBRUARY 23, 1997

WHEREAS, President Clinton has made higher education a central priority of his second term; and

WHEREAS, the Administration has proposed a set of initiatives that, taken together, would ease the burden that students and their families face in financing a higher education; and

WHEREAS, these initiatives include the largest Pell Grant funding increase in the program's history, raising award levels for all students, making an additional 400,000 low-income students eligible, and correcting a long-standing inequity in the treatment of independent students; and

WHEREAS, President Clinton has urged colleges and universities to utilize increased funding in the Federal Work-Study Program to strengthen literacy training efforts; and

WHEREAS, the Administration has proposed the creation of Hope Scholarships, a nonrefundable $1,500 tax credit; a $10,000 tax deduction for higher education expenses; extending the tax exemption for employer-provided education assistance; and authorizing the flexible use of individual retirement accounts for college expenses; and

WHEREAS, the breadth of these recommendations, and the bipartisan interest they have sparked, signify a comprehensive and complementary set of programs that will benefit low- and middle- income families;

THEREFORE, BE IT RESOLVED that the Board of Directors of the American Council on Education:

(1) Commends President Clinton for his exemplary leadership in developing public policy initiatives that will enhance access to college for American families; and

(2) Strongly supports the elements of the President's plan, including increased Pell grant funding, Hope Scholarships, tax deductions, employer-provided education assistance, and the flexible use of retirement accounts to help finance higher education; and

(3) Encourages colleges and universities to participate in the America Reads program; and

4) Looks forward with enthusiasm to working with the President and the Congress in a bipartisan fashion to enact legislation to further open the doors of higher education.

AMERICAN COUNCIL ON EDUCATION ATTACHMENT 1B

RESOLUTION BY THE BOARD OF DIRECTORS OF THE AMERICAN COUNCIL ON EDUCATION IN SUPPORT OF CONGRESSIONAL TAX PROPOSALS TO HELP FAMILIES AFFORD HIGHER EDUCATION FEBRUARY 23, 1997

WHEREAS, the beginning of the 105th Congress has been marked by an outpouring of interest in using the tax code to help families finance higher education; and

WHEREAS, this interest is genuine, bipartisan, and unprecedented; and

WHEREAS, legislation under consideration would restore the deductibility of interest on student loans, make permanent the tax exclusion of employer-provided education assistance, permit the more flexible use of individual retirement accounts to meet college expenses, and provide tax incentives to save for college expenses; and

WHEREAS, President Clinton also has recommended a large number of initiatives that would provide tax incentives to help families finance higher education; and

WHEREAS, these proposals will increase access to higher education for students from low- and middle-income families;

THEREFORE, BE IT RESOLVED that the Board of Directors of the American Council on Education:

(1) Commends and thanks the leadership of both parties in Congress for their bipartisan vision and commitment to increasing access to higher education; and

(2) Pledges to work with all members of the House and Senate and the Clinton Administration to refine and enact tax policies that would help low- and middle-income families finance higher education.

ATTACHMENT 2

CHARLES B. KNAPP
ACE REMARKS RE HOPE
WITH PRESIDENT CLINTON
FEBRUARY 24, 1997

President Clinton, Secretary Riley, and Distinguished Guests.

I am pleased to have this opportunity to speak with you today about the HOPE Scholarship, about the profound effect the scholarship has had on the State of Georgia and on my University and about what I believe a National HOPE Scholarship can mean to our Country.

Many of you have already heard the "Gee Whiz" statistics about the HOPE Scholarship in Georgia. At The University of Georgia alone students are receiving approximately $30 million in aid through HOPE this year. For those of you who keep track of such things that's the equivalent of a $600 million scholarship endowment. And this past fall at the University about 97 percent of our in-state freshman were tuition free under the HOPE Program. All this has been accomplished without the grade inflation or the rapid increases in tuition that many had predicted.

The bottom line is that the impact of the HOPE Program on Georgia's institutions of higher education has been positive, powerful and revolutionary. It may therefore seem odd for me to tell you today that I do not believe that the most important effect of the program has been within the walls of our colleges and universities.

What Governor Zell Miller understood when he designed the Hope Program, was that Georgia is in the midst of profound economic change. Half way through this century per capita income in Georgia was about half the national average. We have now basically caught up. But this progress was based on the traditional sunbelt recipe for growth; low wages, low taxes and abundant natural resources.

In the 1990s, however, the economic growth model in Georgia has radically changed. And the change doesn't just apply to Georgia and the sunbelt. Cut to its essence we all now live in a world where human resources are more important than physical resources and where differences in education will decide which states and nations prosper, and which fail.

Think of all the vacuous messages we send to our young people about what is important and valued in our society — tennis shoes, starter jackets, and even drugs. What HOPE does in Georgia, and what I believe a HOPE Program can do for our Country, is to send a signal straight from the government to the heart of our homes and families. The message is simple but powerful — educational achievement matters.

Georgia does not now have an education culture. But Governor Miller knew we would have to have one to be successful and the HOPE Scholarship is right now bringing about this transformation. Can you imagine as evening falls in Georgia tonight, and young people

try to head for their TVs or the mall, what their parents are telling them: "Junior get back in here -- you are going to win that HOPE Scholarship!"

Mr. President, I know that you understand that the challenges Georgia faces are the same challenges that face America. The foundation of that bridge to the 21st century is in fact education. And I am proud that you have shown the wisdom and courage to make education the centerpiece of your American agenda.

My colleagues, you and I have been entrusted with the leadership of one of America's most treasured assets, our system of higher education. Now is not the time for us to be timid or to quibble about details. At this moment it is our responsibility to help President Clinton lead us in the education culture that is so critical to the future of our nation.

He needs and deserves our strong, unambiguous support. Let's make sure he gets it.

Five-Year Average Annual Increases in Federal Student Aid, Tuition, and Cost of Attendance, 1971 to 1995

	Federal	Tuition		Cost of Attendance	
	Student Aid	Private 4-year	Public 4-year	Private 4-year	Public 4-year
1971-1975	21%	7%	7%	6%	6%
1976-1980	11%	9%	8%	9%	7%
1981-1985	2%	11%	10%	11%	9%
1986-1990	6%	8%	7%	7%	6%
1991-1995	12%	6%	8%	6%	5%

ATTACHMENT 3

ACE, Division of Governmental Relations

STATEMENT OF HON. LAWRENCE J. DeNARDIS, FORMER MEMBER OF CONGRESS; AND PRESIDENT, UNIVERSITY OF NEW HAVEN, WEST HAVEN, CONNECTICUT, ON BEHALF OF THE NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES

Mr. DENARDIS. Mr. Chairman, Representative Thurman, my name is Larry DeNardis. I am the president of the University of New Haven. I also serve on the board of directors of the National Association of Independent Colleges and Universities. NAICU is an association that represents approximately 900 private, nonprofit colleges and universities in this country with nearly 3 million students enrolled in their academic programs.

Let me also add that when I served in this distinguished body, lo those many years ago, the 97th Congress, representing the 3d District of Connecticut, my primary legislative assignment, though not on this Committee, was on the Committee on Education and Labor, where I served on the Subcommittee on Postsecondary Education and therefore had a chance to work on the reauthorization of the Higher Education Act in that period, 1981, 1982.

The actions that you take in fashioning a package of tax incentives to assist students and families with their college expenses will have a direct and meaningful impact on families that are facing the challenges of financing their children's college education.

But I think that you also have a chance to accomplish something quite more meaningful, and much more important. You have the chance to send a powerful message to American high school students, that if you work hard, if you successfully challenge a precollegiate curriculum, then the Federal Government will see to it that you have the resources to go on to college.

What could be more powerful? What better legacy for us to leave than to fundamentally reshape the expectations of families and children about whether a college education is in their future?

These proposals, when appropriately linked to the Federal student aid programs, will tell students, in clear and convincing terms, that if they want to attend college, they can.

This commitment to our Nation's youth will also give a boost to, quite frankly, principals, teachers, and to educators at all levels seeking to improve their students' academic performance.

A strong commitment to Federal aid to college students has the power to reshape our educational system, indeed, our economy, in numerous ways.

The specific tax proposals before you, when viewed together—and they must be—illustrate a central point that I want to leave with you today.

Families plan for and pay college expenses in very different ways and over a number of years.

For example, they save money while their children are young, in anticipation of their education. They may tighten their belts to pay college expenses while their children are in college, and they may have to borrow to meet these expenses.

NAICU believes that there are appropriate ways to ease the burden at each step of the process. The challenges that lie ahead are quite simple. How can we assemble a package of proposals that collectively represent the best ideas to help families with their college expenses.

My full testimony includes thoughts about the array of proposals that are before the Committee, so I will not repeat my formal testimony.

But I would like to make a comment or two about some aspects of it. One item that is not getting as much attention today, but I am sure it will in due course, is section 127 of the Tax Code.

Let me tell you that representing the kind of institution that I do—private, urban, relatively nonendowed, serving an urban population in our metropolitan area, consisting of a lot of part-time students, and a very large and growing graduate school serving working professionals who attend on a part-time basis—section 127, the Employer-Provided Educational Assistance Program is enormously important.

As you know, the administration has proposed to extend the exclusion for employer-provided educational assistance, what we call section 127, through December 31, the year 2000.

The administration would also like to reinstate the exclusion for graduate level courses. NAICU strongly supports permanent extension of section 127 for both undergraduate and graduate education.

We have a situation with this program, as you know, and you took this up last year, and so I think you are well aware of the feel-

ing that we, out beyond the beltway, have. We have an on-again, off-again treatment of employer-provided educational system.

It causes confusion among employees. It causes extra paperwork for employers, and it can very negatively impact university budgets, that is, universities like the one that I preside over, where we have so many adult working students who are fortunate to be employed by companies that offer this benefit.

And these employees, when confronted with a suspension of 127, as happened last year, and 2 years before that, and 2 years before that—the way they react is to take a semester off if they are undergraduates, or a trimester off if they are graduate students, and if the calendar is on a trimester basis, and they will take more than that off.

They will take two semesters, two trimesters off. They will wait and see. They will wait and see whether there is going to be reinstatement. Because most of them, at this point, are not willing to bet on when reinstatement will occur, and they are not willing to bet that both undergraduate and graduate education will be covered, and last year they were right because graduate education was dropped.

So I would hope that you would see these problems, that you would see the unintended effects of an on-again, off-again use of section 127. I believe that it is a very important provision for encouraging additional training for our work force, and I think it is also important to bear in mind, that this is a private-sector program.

Employers establish the program, they work to identify the education and training requirements of their employees, and they also often establish certain academic performance requirements for eligibility for their program.

In Connecticut, we are fortunate to have a number of companies that offer this assistance. My school serves a number of people who work at large centers of the defense industry now engaged in a build-down.

But we have at our university thousands of workers from Sikorsky, from Pratt Whitney, and from the Electric Boat Division of General Dynamics.

They are trying to prepare for the defense build-down that they currently see, and their employers have been good enough to continue these benefit programs as they look to careers, perhaps, within a diversified industry of their own company, or in diversification efforts of other companies.

So I urge you to make 127 permanent. More generally, I would note that many of the issues that are before you have bipartisan support, and I would encourage you to find a common ground on these various proposals.

Our goal ought to be to find a way to take the best ideas and to assemble them in a coherent policy to assist families with their college expenses.

It has been suggested that some of these proposals may have certain unintended consequences like causing increased tuition levels or that they represent a retreat from the principles of current, need-based student aid programs.

Let me say that according to some research that we have done at NAICU, instead of causing increases in tuition, Federal grant aid to students actually helps to slow the rate of tuition growth at independent colleges and universities.

We can supply that study to you and would be happy to do so for the record.

[The study is being retained in the Committee files.]

Mr. DENARDIS. I would also like to touch, briefly, upon the importance of the traditional need-based student aid programs that we find in title IV of the Higher Education Act; Pell grants which have been discussed previously, the Work-Study Program, Perkin loans, supplemental educational opportunity grants, and the State Student Incentive Grant Programs.

These programs have literally transformed American higher education. No longer are the doors to college closed to hardworking, talented Americans solely because of their economic circumstances.

These proven programs must remain the cornerstone of Federal student aid. As you pursue the worthy task of designing tax incentives to help families save and pay for college, please work to ensure that your new efforts dovetail with the historic Federal role in this area.

Naturally, the Association and its staff, and all of us who preside over private colleges from coast to coast stand ready to assist you in this effort. Thank you.

[The prepared statement and attachment follow:]

Statement of Hon. Lawrence J. DeNardis, Former Member of Congress; and President, University of New Haven, West Haven, Connecticut; on behalf of the National Association of Independent Colleges and Universities

Good morning, Chairman Archer and members of the committee. I am deeply grateful for the invitation to talk with you today about the variety of proposals designed to assist students and their families with college expenses. My name is Lawrence J. DeNardis and I am president of the University of New Haven. I also serve on the Board of Directors of the National Association of Independent Colleges and Universities (NAICU). I am here this morning representing the 900 private, nonprofit colleges and universities that belong to NAICU, and the nearly three million students enrolled in their academic programs.

The University of New Haven is an independent, comprehensive university located in southern Connecticut at the gateway to New England. The University has 6,000 students, including 1,500 full-time undergraduate students, 2,000 part-time undergraduates, and 2,500 graduate students. We offer over 100 programs through six schools: Arts and Sciences, Business, Engineering, Hotel-Restaurant and Tourism Administration, Public Safety, and Professional Studies and the Graduate School. Our focus is to prepare both traditional and returning students for successful careers and productive, self-reliant and ethical service to our local and global society.

The tax proposals before you, when viewed together, illustrate a central point that I want to leave with you today. Families plan for and pay college expenses in very different ways, and over a number of years. For example, they may save money while their children are young in anticipation of their children's education. They may tighten their belts to pay college expenses while their children are in college, and they may have to borrow to meet these expenses.

NAICU believes that there are appropriate ways to ease the burden at each step of this process. The benefits to society fully justify the modest sharing of these burdens between families and the federal government. The challenge that lies ahead is quite simple: How can we assemble a package of proposals that collectively represent the best ideas to help families with their college expenses.

SUMMARY OF ISSUES

Incentives to Save for College

On a bipartisan basis, members have introduced legislation to encourage Americans to save, not just for their retirement, but also for future college expenses. NAICU believes that these proposals are an important building block for any package of higher education tax proposals that the Committee may consider.

For example, taxpayers would be allowed to establish a new type of savings plan, using after-tax dollars. As long as certain requirements were met, these plans would be available for future college expenses. In addition, these proposals would encourage Americans to establish and fund, often using tax deductible contributions, Individual Retirement Accounts (IRA). These IRAs would be flexible enough to allow families to withdraw some of their savings to help with college expenses.

By adopting these types of proposals, we would be sending a powerful signal to families that saving for their children's education is critically important. It would reaffirm the central role that parents should have in financing their children's education.

The proposals, in various forms, have been put forward by the Administration, and by members of both parties, and are strongly supported in both the House and Senate. I encourage you to take the final step and establish savings vehicles to help parents prepare for their children's college education.

Hope Scholarships

The Administration has proposed a non-refundable tax credit of up to $1,500 for certain higher education expenses. This tax credit, called the Hope Scholarship, was modelled after the Hope Scholarship ("Helping Outstanding Students Educationally") program instituted in Georgia in 1993. The proposal has been designed to help ensure that students can attend at least two years of college.

The proposal has two elements that have been the focus of significant attention. The first is that, for students and their families to be eligible to claim the credit in the second year, the student must have maintained a B average during their first year. The other provision reduces the maximum amount of the credit, on a dollar for dollar basis, by any other federal grant assistance.

NAICU believes that, while well-intentioned, the requirement that students maintain a B average to remain eligible for the tax credit in the second year creates a series of significant issues.

This requirement represents a significant intrusion into the academic affairs of colleges and universities by creating a new relationship between the IRS and college professors. We do not subscribe to the view that there will be wholesale grade inflation if this proposal were signed into law. The experience in Georgia tells us that such an outcome is unlikely—approximately one-half of the freshmen with Hope Scholarships did not maintain the requisite B average needed to remain eligible for the scholarship in their sophomore year. However, to the extent that students may adjust their academic program or schedule of classes to remain eligible for this tax credit, the credit would distort the academic decisions of those students who need, financially, to claim this credit.

The B average requirement also raises equity issues. According to U.S. Department of Education data, academic performance by race and ethnicity varies significantly. The National Postsecondary Student Aid Study (NPSAS:93) shows that the proportion of students earning a 3.0 cumulative grade point average or higher ranged as follows:

White, non-hispanic	48.5%
Asian-Pacific Islander	46.9%
Native American	40.4%
Hispanic	35.3%
Black, non-hispanic	29.3%

While the Hope Scholarship tax credit would be available to students whose grade point average was 2.75 or higher, we believe this data raises an important issue and would, therefore, urge you to seriously re-consider whether the requirement to maintain a B average should be part of any higher education tax package.

Tax Deduction for College Expenses

The Administration has proposed an above-the-line deduction for college tuition, to be phased in over the next two years to its maximum level of $10,000. To be eligi-

ble to claim this deduction, students must be enrolled on at least a half-time basis, unless they are taking a course to obtain or improve job skills. NAICU believes that, as a matter of tax and education policy, students and families should be able to pay college expenses with before-tax dollars. Education is an investment in the future of our children and our nation. Just as companies are allowed a deduction for plant and equipment—which are investments for their future—so to should families be allowed a deduction for their investments. An above-the-line deduction for college tuition would significantly lower the cost of attending college for millions of families, and we urge its enactment.

Employer-Provided Educational Assistance

The Administration has proposed to extend the exclusion for employer-provided educational assistance (section 127) through December 31, 2000. The Administration proposal would also reinstate the exclusion for graduate-level courses, and apply a new tax credit to encourage small businesses to provide educational assistance to their employees. NAICU strongly supports the permanent extension of section 127, for both undergraduate and graduate classes. We believe this legislation should be a high priority for this committee. This legislation would eliminate the on-again, off-again treatment of employer provided educational assistance, which causes confusion among employees and extra paperwork for employers. These two problems directly counteract an intended effect of section 127, namely, to encourage additional training for our workforce. It is also important to bear in mind that this is a private sector program. Employers establish the program. Employers work to identify the educational and training requirements of their employees. Employers may establish certain academic performance standards to be eligible under their program.

NAICU does not have a position on the Administration's proposal to create a tax credit for small businesses to offer educational benefits to their employees. However, we encourage your careful review of this and other ways to encourage small companies to establish these plans.

Tax Treatment of Scholarships and Fellowships

Under current law, most grant assistance is not taxed to students. An exception to this rule are grants made to students, in return for which the student is required to perform services for the grantor. For example, Federal Work Study awards, a form of federal student aid, is considered taxable income to students receiving these awards.

NAICU strongly believes that subjecting students to tax on grant awards of any kind is inappropriate and unnecessary. Taxing grant awards to students simply makes attending college more expensive for many college students. We urge you to clarify these rules so that students do not face an unnecessary tax burden while they are attending college.

Student Loan Interest Deduction

Proposals have been introduced in Congress that would create an above-the-line deduction for certain student loan interest. These proposals would limit the deduction in various ways. These proposals would phase the deduction out at certain income levels, and limit the deduction in both dollar amounts and in the types of repayments that would be eligible.

NAICU supports the deductibility of educational loan interest. This represents an important tool to assist students and families to repay their college loans, the final stage in which families pay for their children's education. These proposals also correct an inequity in current law, under which certain home equity loans used to meet college expenses are tax deductible. These proposals would allow most families to deduct the interest they pay on their college loans.

Tax Treatment of Loan Forgiveness

Under current law, there is an anomaly in the student loan forgiveness provisions, found in section 108(f) of the tax code. Under this provision, students may have portions, or all of a student loan forgiven without incurring a tax liability, if they pursue careers in certain fields, but only if the loan was forgiven by a public entity, such as the federal or state government. Consider the example of two students, one attending a public university, and one attending a private university. One student borrowed through a state-sponsored student loan program, and the other borrowed under a loan program operated by the college. Both students graduate and take jobs teaching in a Head Start classroom. Under the state program, a borrower who works in a Head Start classroom is eligible to have their student loan forgiven. If that happens, the student also would not owe tax on the amount of the loan forgiven by the state. However, if the private university, utilizing iden-

tical criteria as the state, forgave the loans it made to the other student, then that student would owe tax on the amount forgiven.

The Administration has proposed to apply the same rules to private colleges and universities that currently apply in the public sector. A similar proposal was passed by Congress in 1992 as part of a larger tax package, only to be vetoed for unrelated reasons. NAICU believes this is a meritorious proposal, with only a minor revenue impact, and is deserving of your support.

Equitable Treatment for 501(c)(3) Bonds

Independent colleges and universities, like their counterparts financed by state and local governments, have traditionally used tax-exempt financing for the construction, renovation, and modernization of facilities they use in their educational and research activities. Prior to the 1986 Tax Reform Act, this financing was generally available to both independent and public colleges and universities on the same basis, in recognition that both sectors serve the same important public purposes. The tax legislation passed in 1986 restricted the access of independent colleges and universities to tax exempt financing by imposing a $150 million volume cap. Since that time, that cap has damaged efforts to improve the education activities and research capabilities at private colleges and universities around the country.

Legislation has been introduced in the 105th Congress (H.R. 197) to repeal this restriction and to treat bonds issued on behalf of section 501(c)(3) organizations comprably to those issued on behalf of public institutions. NAICU strongly supports legislation to repeal this limitation, and urges your prompt consideration of this bill.

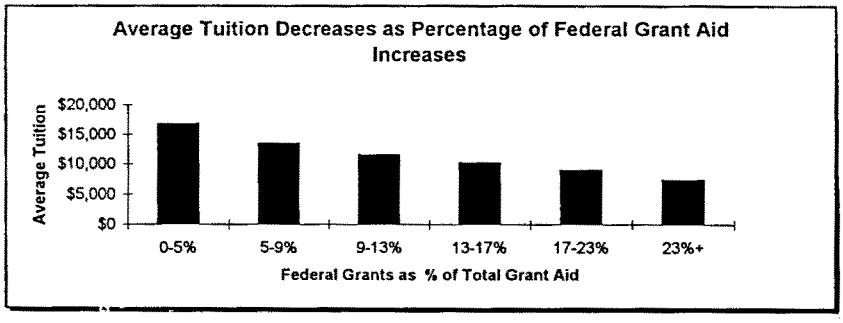
GENERAL COMMENTS

Observers have suggested that some of these proposals may have certain unintended consequences, such as causing increased tuition levels, or that they represent a retreat from the principles of the current need-based student aid programs.

Impact on College Tuition

Instead of causing increases in tuition, federal grant aid to students actually helps to slow the rate of tuition growth at independent colleges and universities. Federal grant aid to students has a significant moderating effect on increases in tuition and fees in independent higher education. Data analyses of a representative sample of 580 four-year independent colleges and universities, enrolling approximately 2 million of the 2.9 million students in independent higher education, demonstrate emphatically that increases in federal student grant aid actually lower the rate of tuition growth. But as the availability of federal student grant aid has decreased, the rate of tuition growth has increased.

The figure below shows that independent institutions with less than 5 percent of their total student grant aid from federal sources have the highest average tuition, while institutions with more than 23 percent of total student grant aid from federal sources have the lowest average tuition. Additional evidence of the moderation effects that federal student grant aid has on tuition is found in the results of the statistical analysis in the attachment to this testimony.



Source: Human Capital Research Corporation, 1997.

Importance of Need-Based Financial Aid Programs

Finally, I would like to touch briefly upon the importance of the traditional need-based student aid programs found in Title IV of the Higher Education Act. Since

1965, these constellation of programs—student loans, Pell Grants, Federal Work Study, Perkin Loans, Supplemental Educational Opportunity Grants (SEOG), and State Student Incentive Grants (SSIG)—have transferred American higher education. No longer are the doors to college closed to hard-working, talented Americans solely because of economic circumstances.

These proven programs should and must remain the cornerstone of federal student aid. As you pursue the worthy task of designing tax incentive to help families save and pay for college, please work to ensure that your new efforts dovetail with the historic federal role in this area.

If done appropriately, the steps you take in this area will be historic and represent the opportunity of a generation to make a huge difference in the availability of college to all.

We stand ready to do our part to assist you in this effort by providing technical assistance, by generating public support and by pledges to continue in our effort to cut costs on campus. I look forward to our work together.

CONCLUSION

The actions you take in fashioning a package of tax incentives to assist students and families with their college expenses will have a direct and meaningful impact on families that are facing the challenges of financing their children's college education.

But you also have the chance to accomplish something much more meaningful—much more important, I believe. You have the chance to send a powerful message to American high school students that if you work hard, if you successfully challenge a precollegiate curriculum, then the federal government will see that you have the resources to go on to success in college.

What could be more powerful? What better legacy for us to leave than to fundamentally reshape the expectations of families and children about whether a college education is in their future. These proposals, when appropriately linked to federal student aid programs, will tell students in clear and convincing terms that if they want to attend college, they can.

This message, this commitment to our nation's youth, will also give a boost to principals and teachers—to educators at all levels—seeking to improve their student's academic performance. A strong commitment to federal aid to college students has the power to reshape our education system—indeed, our economy and our communities—in numerous ways. I am encouraged that you are having this debate, and I am proud to be a part of it.

Mr. Chairman, thank you for the opportunity to appear before you today. I would be happy to respond to any questions you, or members of the committee, may have.

ATTACHMENT

About the Database and Study Methodology

The data used in this study were from publicly available databases from the U.S. Department of Education. One source was the National Postsecondary Student Aid Study (NPSAS), 1990 and 1993. Custom tabulations were constructed to examine the financial aid packages by family income for all full-time, full-year dependent students attending public and independent four-year colleges and universities. Family income categories were adjusted to 1995 by using the Consumer Price Index. Estimates of grant awards, percent of students receiving aid, and net price figures for fiscal year 1996 were developed by adjusting the average institutional grant aid data reported in 1993 and projected for future years. The projection assumes that in aggregate, institutional grant award rates will be unchanged. This rate was applied to the average published tuition as reported by the annual survey of tuition by the College Board.

Two other sources of data were from the Integrated Postsecondary Education Data System (IPEDS) for information on finance, enrollment, and institutional characteristics for fiscal years 1993, 1994, and 1995, data from institutional (FISOP) reports to the U.S. Department of Education on the use of federal student aid funds. Information includes aggregated tuition revenue for undergraduate and graduate students, the number of students applying for financial aid, total state grant aid, and Pell Grant and Supplemental Education Opportunity Grant funds. These databases were merged after matching or reconciling differences in the identification numbers of the institutions.

In merging the data files, any institution that did not respond to one of the reports for the three year period was dropped from the analysis in order to ensure a consistent set of data over time. In contrast with other cross-sectional analyses that appear in the literature, this analysis of tuition, institutionally provided aid, and educational costs is based on full-year equivalent (FYE) enrollments that equate published tuition with aggregate undergraduate tuition revenue. This definition ensures that published tuition levels will be properly related to educational costs and investment in financial aid.

The FYE variable itself was constructed first by adjusting the FISOP and undergraduate and graduate aggregate tuition revenues to match aggregate tuition as reported in the IPEDS finance report. On average, these two sources of aggregate tuition differed by one or two percent. Aggregate undergraduate tuition revenue was then divided by the published tuition for undergraduate students for each institution as reported in the IPEDS institutional characteristics report.

After the databases were merged and the FYE variable was constructed, a variable designed to reflect educational costs (EC) was constructed to reflect direct and indirect educational costs funded through the institutions' current operating

budget. The EC variable was constructed from the following expenditure categories as follows:

[Instruction/(Instruction + Research + Public Service) x (Academic Support, Mandatory Transfers, Institutional Support, and Physical Plant Operations and Maintenance)] + Instruction + Academic Support

The educational cost variable is intended to "net out" institutional expenditures for research and public service and a proration of overhead that would be associated with these two budget categories. The EC variable thus offers a basic measure of educational service and related support expenditures that are rendered directly or indirectly to students.

The data files were then sorted and a small number of institutions with values that appeared to be incorrect because of data entry errors or some other reason (e.g., educational costs of more than $150,000 per student) were eliminated from the analysis. In all, the merged database resulted in usable data for 580 four-year independent colleges and universities, which enroll approximately 2 million of the 2.9 million students in independent higher education. More than 25 key variables for each of the three years of analysis were used.

A series of multiple regression analyses were employed to explore the relationship between tuition and selected variables including educational costs, institution size and type, state and regional markets, composition of revenue sources including federal grant aid and student financial aid characteristics.

The results of one of the regression analyses used to support the conclusion of this study are shown below:

Sample Size: 580 institutions
Adjusted Squared Multiple R: .818

Variable Name	Coefficient	STD Error	STD Coefficient	T-Statistic	Prob (2-tail)
Constant	6,995.60	349.72	0.00	20.00	0.00
Educational Costs per FYE	0.21	0.02	0.35	10.29	0.00
Institutional Aid per FYE	0.63	0.05	0.35	13.45	0.00
Gifts and Endowment Income per FYE	(0.18)	0.03	(0.18)	(5.56)	0.00
State Grant Aid per FYE	(0.17)	0.14	(0.03)	(1.16)	0.25*
% of Students with Incomes > $60,000 Applying for Aid	3,460.55	1,886.08	0.08	3.19	0.00
Pell and SEOG	(0.91)	0.26	(0.08)	(3.43)	0.00
Total FYE Enrollment	0.05	0.03	0.04	1.54	0.13*
Research/Doctoral Univ. Dummy	1,773.75	389.86	0.13	4.45	0.00
Master's Univ. Dummy	622.63	179.71	0.07	3.47	0.00
Baccalaureate I Dummy	2,695.65	232.71	0.28	11.58	0.00
Region 1 Dummy	1,432.34	248.74	0.12	5.76	0.00
Region 4 Dummy	(846.36)	226.25	(0.07)	(3.74)	0.00
Region 5 Dummy	(1,009.25)	201.40	(0.10)	(5.01)	0.00
Region 6 Dummy	(2,340.90)	290.37	(0.16)	(8.06)	0.00
Region 7 Dummy	(2,311,28)	293.99	(0.16)	(7.86)	0.00

* Not statistically significant

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STATEMENT OF OMER E. WADDLES, PRESIDENT, CAREER COLLEGE ASSOCIATION

Mr. WADDLES. Thank you, Mr. Chairman, Mrs. Thurman, it is a pleasure to be here. Thank you for the opportunity to come and testify, to express some of our views. I represent the Career College Association, a trade association comprised of a little over 700 schools that provide technical career training to individuals.

One of the things that I want to bring to the table today is the idea that there is a broad spectrum of training and education that goes on in this country.

We have a multitude of faces that are represented at this table, which represent the full spectrum of education offered throughout the country. Together we provide the training and education which fulfill the hopes and dreams of Americans as they pursue their individual career goals and objectives.

We have an opportunity to explore for the first time, I think in this Committee, this manner of educational assistance in a new light. It is exciting for all of us to be a part of this taxation process which enables us to lift off the lid for a moment and take a critical look at a very complex and challenging system of funding for higher education. It is exciting because with the various tax proposals we have an opportunity to create additional benefits for Americans across the country to pursue higher education.

This opportunity can enable us to address a number of issues. One of the things that I have found in listening today is that maybe we have made the system too complex and the reality is that before we make any additional changes we need to be listening. Congressman Rangel and Senator Coverdell were talking about this earlier this morning, the issue of bringing businesses into the discussion and listening to the marketplace—utilizing a variety of voices that historically we have used only in a very narrow and limited fashion.

That this is an opportunity to broaden that process and to, for the first time, really bring the marketplace into the decision-making.

One of the things that I asked the staff to lay out on the Members' desks today—it only came out Monday so I was unable to make it part of my testimony—but an article was in USA Today on the money page, right at the top of the page, "High Tech Skills Give Auto Mechanics More Power."

And it talks about the treatment of the auto mechanics in many ways, like high-priced athletes, where they are given signing bonuses, assistance in seeking housing, and additional salary levels that they had not anticipated.

And they talk about BMW, Mercedes, Ford, Volkswagen, Volvo, tapping into technical schools to find these workers.This is what the marketplace is looking for. One of the recent Kiplinger Washington letters that I was going through as I was preparing for the testimony, back on January 24, talked about the hardest jobs to fill. Truck drivers. Tool and die makers. Machinists. Auto mechanics. Skilled construction workers. Plumbers. Electricians. And many others, engineers and others.

But again, as you approach this, you need to look at this in a very broad approach, and not allow the Committee to become pigeonholed into the process.

Comments concerning the President's proposals. The President's proposals, in many ways, I think, we have a tendency to look at one portion of them and try to solve all of the ills and challenges that we confront in the higher education community with one, two, or three elements. It is a very complicated process.

The $10,000 deduction was first promoted as a result of a middle-class tax break. Well, that is what it does.

We have heard a variety of testimony today talking about how it helps this population, does not help that population. When it was

originally drafted, it was not supposed to provide access for all students. It was targeted at a certain population. The $1,500 tax credit, another area that you can consider assisting some portion of the population, but it does not solve all the problems either.

Additions to the Federal Pell Grant Program are critical to this process. This grant aid is targeted and therefore provides a significant portion on the population that is most in need with funds necessary to pursue their chosen educational path.

One of the things concerning our population is people would have a tendency to say, well, people going to trade and technical schools may be at the lower end of the economic spectrum.

A recent survey of CCA member institutions has shown that 30 percent of the students we train make over $30,000 a year. The survey also indicated that a larger proportion of our student population, about 47 to 48 percent, make less than $15,000.

Well, as a result of that we can see how these tax credits can help a certain portion of our population, a smaller part, but one that is representative of the nontraditional population.

The other part, we think that the Pell grant addition is an important element to that, that addresses their concerns, as does the change in the independent student process, the eligibility of those individuals.

That will enable a larger proportion of the population to qualify. There are elements to the proposals that we do have concerns over and we are not endorsing the administration's proposal.

We are saying that the concepts it promotes are exciting. It is exciting to have the dialog continue and we need to move forward with it.

The IRS provisions send chills up and down the spines of parents, students, schools, administrators, about how that is going to be administered.

I don't believe that anyone in the community harbors any ill will toward the IRS, but many of us are concerned how they will be involved in the process and what complexities may arise as a result.

The targeting of the populations is a critical element to this process and your greatest challenge as you move forward with the delineation of the kinds of assistance that you can provide.

One of the things that I heard earlier today was the dialog between Congressman Rangel and Senator Coverdell.

The idea of reaching out to each other and having a dialog that goes beyond just a single Committee of jurisdiction is extremely important.

I had the privilege of serving at the staff level in the Congress for the last 12 years, both on the House and the Senate side, and I am very aware of the jurisdictional lines that occur as these kinds of debates move forward.

Because of the complexity of issues, it is critical that we do enlarge the debate, we do bring to the table more than just the Members of Congress. The people in the community, as you are doing today, and I congratulate for that, but also the business community and others that are around the table, need to be there.

From our perspective, the main message that I want to leave with you is one of inclusion. One of the things that we see in the

President's proposal that is heartening and is supportive is the inclusion of our community and sector in the provisions.

CCA does call to your attention that there are elements of the legislation that have been introduced in both the House and Senate, that may not intentionally exclude portions of the higher education community and the students they serve, but in fact do.

And so we come to the table, suggesting to you that we have, as in our communication with the Majority staff, shared with them language that would make sure that the populations that represent this broad array that we have before you are included in the legislation.

A copy of the letter to the Majority staff is included with my testimony. We have done the same with the Senate side and received a very positive reception as a result of that.

That inclusion, as you move forward through the technical complex language of title IV and the Higher Education Assistance Act, and the rest of the IRS Code and the respective provisions dealing with the prepaid tuitions, with the IRA provisions—all of those are elements that parents, students, adults, throughout their career, throughout their life, should have their opportunity to make their choice at the market demands.

Thank you very much for the opportunity to provide the testimony and I look forward to this being the beginning of a dialog, beginning of a conversation as we move forward. Thank you.

[The prepared statement and attachments follow:]

Statement of Omer E. Waddles, President, Career College Association

Mr. Chairman and Members of the Committee:

I am Omer Waddles, the President of the Career College Association. I would like to take this opportunity to thank you for the invitation to testify today. I will be providing the Career College Association's views and comments relating to the President's recently proposed changes to the tax code. I will also be commenting on how those changes will affect students and access to postsecondary education.

CAREER COLLEGE ASSOCIATION

The Career College Association (CCA) is a group of over 700 educational institutions offering career-specific educational programs. The variety of member institutions that make up this organizations educate nearly one million students in over 200 occupational fields throughout the nation. CCA schools graduate almost one half of the technically-trained workers who enter the workforce with training beyond the high school level.

In addition to the varied curriculum alternatives, CCA schools now provide a critical source of industry-based skill upgrading for front-line workers. It is true that a worker's career path will potentially change as many as seven to ten times in a working life. We are proud that our schools are able to provide America's workforce the chance to seek skills necessary to ensure an ability to adapt to these paths. CCA institutions offer programs which provide individuals certificates, two-year Associate of Arts degrees, baccalaureate degrees, and master degrees. In addition, a strong unifying belief of our community is that while we are determined to provide the best training possible for our nation's workforce, we are also committed to achieving the highest possible standards of educational quality.

While our association is a truly diverse group of institutions it is clear that we have the unique ability to be extremely responsive to the market place. Our schools know that it is imperative that we are successful in tailoring our services and products to the needs of today's employers. While thinking beyond today's market place demands, we must improve our ability to foresee the skills-sets which tomorrow's world of work will be demanding.

An important difference for our schools is that they seek excellence through a healthy and vibrant entrepreneurial spirit. This spirit ensures that our schools are engaged in the necessary cutting-edge training which provides a wide array of services and training components. To survive over the long term, our member institu-

tions must continue to provide the best quality product as measured by the market place. If our schools fail in this mission, then the market will choose to hire the workers from other sources, or even attempt to train the workforce in-house. The students are also able to seek out a different source for their education and training. This is the basic proprietary nature of the vast majority of our institutions.

Allowing the customer to determine the economic success of an institution by deciding with their feet has been a time honored tradition in this nation. If the education and training are inadequate, then the students will seek alternative educational opportunities. Through rigorous accreditation standards and strong state and federal oversight, these institutions also ascribe to a set of principles of quality and access in postsecondary education.

We have seen a dramatic improvement in the quality of this community. Over 1,500 schools have closed over the last five years through a combination of tougher accreditation actions and a variety of mandated quality standards relating to economics, curriculums and legislatively required standards. We know that today's career colleges are far more economically and ethically reliable than those five years ago. As a specific example of this kind of attrition I cite the experience of the Accrediting Council for Independent Colleges and Schools (ACICS). As ACICS reported to the Government Accounting Office (GAO), they have had 345 of the schools they have accredited over the last five years close because of a variety of reasons. This is just one example of an accrediting group which has seen its population drop as a direct result of tougher standards, stricter oversight, and a smarter consumer.

NEW DEBATE

I join with my colleagues in expressing my support for the spirit of the current dialogue associated with the issues on accessing education today. For the first time in many years we are seeing the debate focus on the issue of how and not why. We are becoming united about the clear need to provide a viable series of effective paths to choose from as an individual seeks additional education and training. The President's focus on the first two years after high school is an important period for many in our society. It is a time when important life-impacting decisions are made and skills are developed. I encourage the Committee to keep in mind the similarly important issue of having the opportunity to seek continuing educational opportunities throughout one's life.

As you undertake the process of reviewing the proposed legislation and the communities it will impact, it is important that we provide you the facts and figures describing today's education and training population. As we see an older and more experienced population emerge from the baby boomer generation, it is critical that we all address the reality of today's market place. We must not limit our actions to what we define as the traditional community setting with which we are comfortable from our own past. Today's student population has an increased share of the older and more experienced individuals. We need to be sure that we are not establishing artificial barriers for these students as we design the delivery systems through which we are attempting to provide the open door of opportunity.

HISTORIC CHALLENGE

I have spent a great deal of time listening to Administrators and Presidents of our institutions as they talk about the needs of their communities. The message that has been reverberating is that employers are looking for educated and trained individuals who can jump into the mix immediately and remain flexible as the demands of the economy change around them. This is the workforce of today and we need to adapt our curricula and teaching modules to accommodate industry's unique demands as well as the varied challenges presented by today's student bodies.

It has been an exciting and rewarding experience for our nation over the last 40 years as we have reaped the multitude of benefits provided through a more educated workforce. The newly created access to colleges and universities changed the way our nation viewed their ability to change economic class levels. This also gave new hope to parents that their kids could do "better" than they had done for themselves. This was only true because the markeplace perceived value in the education and training acquired through the new postsecondary opportunities.

With a new array of academic and training structures in place, our nation was able to attain a position of global leadership. This was the result of not only our raw military power, but also because of our intellectual capacity and economic markup superiority. It was clear that our dominance on the world stage has been the result of something more than simply being militarily stronger. The clear need has been to be more creative and resourceful in our approach to managing our human resources. I believe we stand at a similar historic threshold today. We stand

alone again as the clear world power when it comes to our military prowess. Can we cheat the fates of time again and avoid the historic and traditional demise of previous world powers? I believe it is very possible if we look around and identify the available raw materials remaining in our society.

I believe the answer lies in how successful we are at reaching out to the 70%–75% of the high school graduates in this country who do not succeed in achieving a baccalaureate degree. Where do we train these individuals and how do we provide the basics they may have already missed in their secondary education? Those who follow the path of a traditional baccalaureate degree receive their opportunity for maturation during the "college years." We join in celebrating the success of our current system and believe that we can continue to reap the benefits of this positive course.

The cruel societal reality is clear: not everyone takes the same path. We need to be continuing to embrace a broad spectrum of educational and training opportunities. People reach different stages of their own maturation and find their willingness to learn has changed. This is the basic and obvious reason why my community seeks to ensure their continued inclusion in the various programs, including tax programs targeted at our students.

For those wondering whom I am talking about when I refer to our students, I ask you to simply think about the faces you see when you are traveling. We train the travel agents booking the flights you take. We train the airplane pilots and mechanics who take you back and forth to Washington, DC. We train the skilled workforce in the hotels and restaurants you visit. If you get sick then we train everyone in the doctor's office except the physician. If someone is working on your computer at home or in the office we are a major educator and trainer in that field. We even train the court reporters taking notes at these proceedings today. In reality our graduates will be seen in the faces of the people you meet and interact with each day. We take the greatest pride in our work when people can assume the service is available and reliable.

PRESIDENT'S TAX PROPOSALS

I have already stated I believe the President's tax deductions and credits have provided a welcome focus to the national rhetoric relating to our efforts in the areas of education and training. Now, we need to be raising the legitimate and necessary questions concerning the current proposals. We need to explore the appropriateness of the proposed delivery system and what necessary complexities must accompany such a dramatic initiative.

The HOPE Scholarship, the $1,500 tax credit, is still under last minute refinements by the wordsmiths in the Executive branch. We do know that the Administration's intention was to make sure all of the postsecondary populations were eligible to receive the benefits of the tax assistance program. The intent with this credit is to promote the establishment of an opportunity to have an additional two years of education beyond high school. Remaining drug free and achieving a "B" average are two critical thresholds related to retaining eligibility for the tax credit.

A similar description, but without the "B" average, is applicable for the $10,000 deduction option. This proposal allows students to use this assistance in any of the years of postsecondary education is desired. This proposal is the more universal one available for those beyond their first two years of postsecondary work, as well as those unable to qualify for the $1,500 tax credit.

I testify today knowing that any proposals that have a price tag of at least $36 billion over the next five years will pose a challenge to this Congress. I do want to underscore the importance of the goal of creating greater access and encourage your continued attention to such a significant matter.

These two proposals represent the backbone of the tax issues and can be considered through a series of questions.

1. *Does the President's tax cut proposal include the private career schools?*

The Administration's work has been seen as an inclusive effort. There are no apparent attempts to exclude any portions of the population in the draft proposals. We have been assured by individuals in the Department of Education and the White House that this will remain true as the final legislative language is drafted.

This is critical to the 70%–75% of high school graduates who are churning through the workplace looking for some skill development and career path choices.

2. *Is this delivery mechanism the most effective and efficient available?*

The answer to this question depends on the nature of the selected audience that is targeted and the other elements of the package. The original context for the $10,000 tax deduction proposal was as part of a "Middle Income Tax Break" package. The targeted audience was intended to be the average and somewhat more af-

fluent of our society. During the recent campaign, the $1,500 credit was added to the overall proposal. Criticism has emerged that these proposals simply do not adequately assist in opening new doors for lower income individuals.

We need to note that the use of the Pell Grant program and the proposed increase in the maximum award does target the lower income students. If these items can be seen as a total package then it helps to enhance the overall effectiveness of the proposals.

The typical CCA school is seeing an increasingly more mature population attend their institutions. We still have a majority of students coming out of high school but the average age for many of our campuses rests in the 26 to 28 year old age range. This means that our assumptions as to the economic impact of each of the tax changes on our students changes as well.

A recent survey of our students and alumni found that approximately 30% of our students have a household income of above $30,000. This means that a fair number of these individuals should be able to reasonably expect to use the benefit from some type of credit or deduction proposal. At the same time the survey reported 47% of the student population at CCA schools have incomes below $15,000. This is clearly the population that is most likely to benefit from the Pell Grant expansion. This is also true of many of the other sectors of the higher education community.

3. *Why should we be establishing additional complexities and a new pattern of educational oversight through the Internal Revenue Service?*

The call for the IRS to begin measuring the quality of a "B" average is one that quickly sends chills up and down the spines of all students, parents and Title IV participating institutions. This measure seems to quickly underscore the clear concerns that we can get into if we are not careful. There is no assumption on our part the IRS would have any alternative intentions, but it is the by-products that may come from the linkage to these credits that could become a problem. Grade inflation, monitoring techniques and the intrusion of the government into the academic environment are all concerns that need to be examined before we consider stepping blindly into this arena.

The debate over who will determine what a fair grade average is and what role the Government should have is an issue the authorizing committees have also struggled with. This issue must also be considered when weighing the impact on the lower income individuals and their ability to utilize the credits and deductions.

4. *Where are the current budget limitations and how will the cost of these tax proposals impact on established and effective programs like the Pell Grants?*

A fear that has been growing confronts the reality of a finite budget and if we are to pay for the tax cuts, where will the offset occur. The President has laid out a series of tax increases designed to offset most of the cost associated with his tax proposals. It is clear that there will be strong opinions on both sides of the aisle when your Committee considers that package as well.

However, before any agreed-upon tax break package is offset, we want to strongly urge against the temptation of dipping into the Pell Grant program for sacrificing an increase in the maximum award. For those who are interested in making the end legislative product a universal one, we must be sure to look broadly. A single tax proposal is simply not the silver bullet answer. The Pell Grant has proven to be a valuable instrument in reaching the first generation students.

5. *Have we been down this road before?*

We have to be careful as we move down this dual path of tax breaks and Pell increases. The intent to have both the middle income tax break and an increase in the Pell Grant has been tried before. In 1978 a similar scenario played itself out on the national scene. A unified and bi-partisan Congress found itself proposing a tax credit program while the President was announcing plans for the Middle Income Student Assistance legislation. The then Democratic-controlled House of Representatives passed the tax credit legislation and the Republican-controlled Senate passed an expanded Pell Grant and Federally insured loan program. The Congress finally realized that they could not afford to fund both new programs. Finally in the fall of 1978 the Congress decided to adopt the guaranteed loan programs and dropped the tax credit provisions.

A similar competition over funds and initiatives could easily develop again twenty years later and the reality is that the nations is the loser if this process is not handled well. Access and the opportunity to succeed is the education mission of the day. We must be sure to learn from the lessons of the past.

6. *Are there any other tax provisions which can be additional tools for access to all types of populations and which both parties can agree upon?*

a. Section 127 of the Internal Revenue Code—We would encourage the Committee to exclude the value of employer-provided educational assistance from an

individuals's income calculation. This has been one of those on-again off-again benefits for individuals who need a permanent place in the tax code.

This provision is critical to the adult students who are willing to take on the added responsibility of working and also attending school. I see this as an important tool for businesses as they attempt to retool in anticipation of market challenges. Our nation needs to encourage the training and education activities throughout a lifetime of work.

b. Reinstate the deductibility of Student Loan Interest—This tool was a very effective means of getting money back into the pockets of individuals who are repaying their loans. As overall indebtedness has increased so has the burden on individuals as they repay their student loans. Over the last five years we have been very successful at reducing overall student loan default rates.

This proposal has appeal in both the Republican and Democratic leadership as an item that would not require an itemized filing to be applicable. This greatly enhances the usefulness and breadth of the provision and would have a positive impact on more students.

c. Education IRAs, Saving Accounts, Prepaid Tuition Plans, and other preparation tools. These proposals have been coming forward in a variety of forms. We all see these ideas as helpful tools in preparing for attendance at a postsecondary institution.

The Critical component associated with these plans remains a matter of fairness and inclusion. While we attempt to create a full spectrum of choice for students, we need to be sure that all institutions are eligible participants in the incentive packages related to the various saving accounts.

I have already been in contact with the majority staff counsel on this matter, and in response to their request have provided generic language that will ensure a wide array of choice and participation. We do not ask for any kind of earmarking or special treatment.

What we are seeking is to ensure that the students and employers across the nation have the full palate of choices available to them. They are looking for the best fit for their particular needs and circumstances.

CONCLUSION

It is an honor to be able to repond to your request for input on these important matters. I want to underscore our sincere commitment to being a resource for your Committee. I know that you have a number of important economic and legislative challenges in front of you. In addition, many of them are in areas of relatively new matters of law and public policy. If there is anything that we can provide, or assist you with, we would be pleased to work with you.

The faith and passion I have for this community comes from my strong belief that we have an exciting opportunity to benefit from the strength of the American spirit and character. We can never be satisfied with our current position and level of skills in the workplace. We must continue to build on the available national talent and challenge our schools, families, communities and individuals to reach beyond. Education and training initiatives if based on a solid foundation allow for this to occur. I look forward to working together in our community and with the Committee in developing a coherent strategy to accomplish this goal. Thank you for the opportunity to testify today.

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CAREER COLLEGE ASSOCIATION
WASHINGTON, DC 20002
February 25, 1997

Mr. James D. Clark
Tax Counsel
Committee on Ways and Means
1102 Longworth Building
Washington, DC 20515–6348

Dear Mr. Clark:

On behalf of Omer Waddles, President of the Career College Association, I would like to thank you and Mac McKenny for meeting with us on February 13 and allowing us to share with you the mission of the Career College Association.

As we discussed, career colleges and schools play a vital role in the preparation of a globally competitive work force. Current las provides the same access to federal financial assistance to students attending the proprietary sector of higher education to those attending traditional colleges and universities. It is critically important to our nation's future to ensure that this equality of opportunity is maintained as new federal assistance programs are created or old ones evolve.

In order to assure that the proprietary sector of postsecondary education is included in the higher education initiatives which will be considered by your Committee, care must be taken in the drafting. To achieve this goal, we suggest the following:

The legislation, in its definition sections, could define an "institution of higher education" for purposes of your legislation, as any institution which is included in the definition of an institution of higher education in section 481 of the Higher Education Act of 1965, as amended, (20 U.S.C. 1088)

(The definition of "Institution" of higher education," as defined under Section 1201 of the Act, covers only the non-profit institutions (primarily the traditional two-year and four year colleges). We would request that the Committee use the more inclusive definition found under Section 481 of the Higher Education Act.)

Again, we stand ready to assist the Committee as a resource if you have any questions or concerns as you proceed with this important legislation.

Sincerely,

BRUCE LEFTWICH
Vice President for Government Relations

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USA TODAY

Money

MONDAY, MARCH 3, 1997

High-tech skills give auto mechanics more power

By Earle Eldridge
USA TODAY

Signing bonuses. Relocation expenses. Big salaries.

Sounds like a star athlete negotiating a contract.

No. These are auto mechanics. Today's entry-level mechanics — computer savvy and good with a wrench — can get signing bonuses, relocation help and top wages.

"These guys are like free agents in the NFL," says Gary Long, service director of Leith BMW in Raleigh, N.C. "And people wonder why our labor rates are so high."

Computers — which can control everything from fuel injection to tire pressure on new cars — have made servicing cars a highly skilled craft.

Today's car has more computer power than the Apollo 11 spacecraft Neil Armstrong flew to the moon in 1969.

Each year, automakers put more technology in new vehicles. That means mechanics — who now call themselves service technicians — must continuously school themselves on the latest technology.

Incorrectly diagnosing a problem can damage a vehicle. And the technology is different for each automaker.

When 25-year-old John Denick of Andover, N.J., prepared to graduate from Lincoln Technical Institute, he expected to get a salary of about $28,000 to $30,000 and land a job after a month or so search. Imagine his surprise, when a couple of dealers offered him a $1,500 signing bonus, help finding a new apartment and an annual salary of $38,000. All before he graduated from a BMW-backed training program.

"I've never seen anything like it," says Denick, who is headed to Las Vegas, his first time away from the East Coast.

Chris Christner, a vice president at Universal Technical Institute, says good mechanics at car dealerships can earn $70,000 to $80,000 a year after three or four years on the job.

BMW, Mercedes, Ford, Volkswagen, Volvo and other automakers are tapping technical schools to find top graduates, then providng six months' additional training on the automaker's vehicles.

Mr. HULSHOF. Mr. Waddles, thanks for your perspective from the Career College Association.

Our final witness, Mr. Appleberry. We welcome you as president of the American Association of State Colleges and Universities. You may proceed, sir.

STATEMENT OF JAMES B. APPLEBERRY, PRESIDENT, AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES; AND NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND-GRANT COLLEGES

Mr. APPLEBERRY. Thank you, Mr. Chairman.

I am James Appleberry, president of the American Association of State Colleges and Universities, and I am here today to represent my organization as well as the National Association of State Universities and Land Grant Colleges, together representing more than 630 campuses and enrolling more than 6 million students.

I also have the endorsement of the Hispanic Association of Colleges and Universities, the National Association for Equal Opportunity in Higher Education, the United Negro College Fund, and the United States Student Association.

I have submitted my written statement and will summarize for you in my allotted time.

I am an educator and former university president, not a tax policy expert. My comments will focus on the public policy consequences of tax proposals for educational access.

Two specific problems regarding student access merit the Committee's attention. First, most low- and middle-income families have financed their cost of attendance through increased borrowing.

Second, the college participation rate for children of families with an annual income of less than $22,000 is below 60 percent.

This is contrasted with the nearly 90 percent participation rates for children of families with incomes in excess of $65,000.

The President deserves enormous credit for having identified the problem of access to higher education as a major national concern, and for proposing the use of the Tax Code to deliver some $36 billion in new resources over the next 5 years.

This is a bold step in our national strategy to increase our investment in human capital. This Committee can use its jurisdiction to help American families prepare themselves and their children for another century of world leadership.

The President's proposals include the following new initiatives. Hope tax credits, tuition tax deductibility, loan forgiveness tax exemption, tax-free educational savings, employer-provided educational benefits.

We would like to express our unqualified support for the last three items. Nontaxability of loan forgiveness, educational savings, and employer-paid educational benefits.

In contrast, the Hope tax credits and the tuition tax deductibility requires significant modification before they can be justified in terms of educational access.

Allow me to address the tax deductibility first. This proposal suffers from the interactive effects of three regressive attributes. One, given the progressive nature of our tax structure, tax deductions generate individual benefits that are inversely proportional to income.

For the taxpayers in the upper end of the eligible income scale, the value of every dollar of the proposed deduction is 28 cents, in contrast to the very neediest families for whom it is worth literally nothing, for they have no tax liability.

Two, the proposal would reduce the allowable deductible expenses in a dollar-for-dollar fashion by any student that receives grant and aid.

Three, the proposal offers the same theoretical opportunity to deduct up to the maximum amounts to all taxpayers, but in reality, not all taxpayers will be able to avail themselves of the deduction equally. The reason: low-income citizens tend to be disproportionately concentrated in lower cost institutions.

Allow me to offer an example. At our Nation's public black colleges the median family income is about $27,000 per year. There, a typical family would confront a total cost of attendance of about $9,000, of which only $2,700 would be for tuition and fees.

Assuming an average Pell grant award of $1,500, this student's family would receive a reduction of less than $200 in their taxes. Contrast that with a typical family with a $73,000 median annual income at our most expensive universities.

Such a family would receive tax benefits of $1,400 now and $2,800 in future years. Our misgivings have to do with the disparity between the benefits of those two families.

The Committee may wish to consider substituting the deductibility of student loan interest in place of deducting tuition costs.

This action would treat loan financing of investments in higher education in the same way that home mortgage interest is treated.

The same logic that led Congress to create a deduction of home mortgage interest instead of the home's purchase price applies in the case of higher education.

This policy has several important advantages. One, deductibility of student loan interest automatically shifts the benefit toward the children of low- and middle-income families who have to finance college education through borrowing.

Two, the interest deductibility is spread out over time and would mitigate some of the ill effects of the student indebtedness on our economy.

Three, deductibility of tuition will do very little for graduate education. The deductibility of student loan interest would immediately become the largest form of financial aid for financing graduate study.

Let me now turn to the Hope tax credit proposal. One, the decision to turn what was originally a refundable tax credit into a nonrefundable one was a step in the wrong direction.

This change specifically channels the benefits of Hope tax credits away from the Americans for whom it could do the most good in terms of access.

Two, the Hope tax credit will be reduced dollar for dollar by the amount of other Federal grant aid received.

Ironically, the negative effects of this netting of Federal grants against Hope credits is even more drastic than it would be in the case of tax deductibility.

Three, the use of the B average magnifies the regressive nature of the proposal and could promote outcomes other than those which are intended.

First, students from at-risk backgrounds tend not to be as academically prepared as those from upper income backgrounds.

Second, neediest students fearing loss of Hope eligibility might be more likely to avoid difficult courses in favor of less challenging work, thereby hoping to ensure a second year of Hope eligibility.

Instead, better results would likely result if the current Federal eligibility standard of satisfactory progress were substituted with proposed specific grade average.

These concerns can be addressed by the Committee in a manner that would fully realize our common goal of greater access for all Americans, a goal espoused both by the President and by Congress. A refundable Hope tax credit, without the Federal grants offset contained in the proposed version and the deductibility of loan interest would be giant steps in the right direction.

Mr. Chairman, we stand ready to work with you and the Committee in any way we can to assist you in the historic task before you and I will be glad to respond to any questions. Thank you.

[The prepared statement follows:]

Statement of James B. Appleberry, President, American Association of State Colleges and Universities; and National Association of State Universities and Land-Grant Colleges

INTRODUCTION

Mr. Chairman, I am James Appleberry, the President of the American Association of State Colleges and Universities (AASCU). I appear before you today on behalf of AASCU and the National Association of State Universities and Land-Grant Colleges (NASULGC). Our two associations represent more than 630 campuses and systems of higher education throughout the nation and its territories. Annually, AASCU and NASULGC universities enroll more than six million students, and award two thirds of all baccalaureate and nearly 60 percent of all master's degrees conferred in the United States. Our members also award two thirds of all doctorates earned in the United States. I am honored to have the endorsement of three important national associations, the Hispanic Association of Colleges and Universities (HACU), the National Association for Equal Opportunity in Higher Education (NAFEO), and United Negro College Fund (UNCF), for the views expressed here. I am also pleased to inform the Committee that the United States Student Association, the nation's largest and oldest student organization, joins us in this submission. I thank you for the opportunity to testify before the Committee.

Mr. Chairman, I appear before you as an educator and former university president, not as a tax policy expert. My testimony on the various tax proposals this Committee will be examining, therefore, will be strictly limited to the public policy consequences of proposed tax incentives for educational access and for public institutions of higher education. The broad range of tax relief proposals this Committee will evaluate in its deliberations under your leadership may all be justifiable in terms of providing tax relief to certain middle-income Americans. I hope my comments today provide you with additional information as to the educational impact of the proposed tax cuts, so that you may better judge the extent to which they merit enactment as sound education policy.

Before addressing any specific initiatives, it may be appropriate for me to set the context within which this Committee begins the important task of examining possible uses of the tax code in support of higher education. Higher education has always been, and continues to be, an indispensable ingredient of our national well-being. College attendance, even if not resulting in college graduation, has civic and economic benefits that have been well documented. Those with any college education are more likely to vote and more likely to engage in volunteer activities than those with only a high school diploma or less. Similarly, fully 66 percent of all personal income taxes collected are paid by those with some college education, and those with

a baccalaureate degree or higher pay 43 percent of all federal personal income taxes while constituting only 23 percent of tax filers.

In our view, the mission of AASCU institutions is to fulfill our nation's democratic ideal of sustaining an enlightened and productive citizenry through the uniquely American attempt at educating not some, but all, of our citizens. Thomas Jefferson captured the essence of the American civic order by describing it as a republican regime under which the old aristocracies of privilege would be replaced by "a natural aristocracy of virtue." What he and other founders had in mind, to put it in more modern terms, was class mobility and the creation of a society in which the children of even the poorest families could realistically aspire to success and affluence if they worked hard. Education has historically been the means of upward mobility and the great equalizer in our society. The gradual broadening of access to higher education for ever greater numbers of our citizens reflects the extent to which we have succeeded in actualizing our ideal society.

EDUCATION POLICY CONTEXT

The evolution of our nation's public higher education infrastructure represents the first historical step in our collective efforts to realize the lofty goals set forth by our founders. The creation of low-cost public colleges and universities, which the federal government assisted through the First Morrill Act, provided educational opportunities for millions of low- and middle-income Americans. The second historical step in the direction of broadening access to higher education was the G.I. bill, which opened the doors of college to millions of veterans, and to which much of America's post-war economic miracle can be attributed. The democratization of higher education in America produced results in less than one generation, and transformed our country into the world's leading and dominant economy. The third giant step in the direction of fulfilling our stated ideals was the creation of need-based aid programs subsumed under the Higher Education Act of 1965 (HEA). The need-based student aid programs contained under Title IV of the HEA have done much to ensure that a want of financial resources does not become an insurmountable roadblock to college education for academically talented, but needy Americans. In this gradualist definition of success, student aid has been wildly successful. It is difficult to say how many of the more than 3.5 million Pell grant recipients could still have attended college this year without aid, or how many of the more than 6 million student borrowers could have obtained sufficient resources to pay their educational expenses on their own. Our view is that without the existing student aid programs, most of our citizens would be unable to pay for their children (or their own) educational costs.

We have, through the combination of state and federal action, managed to take significant steps in the direction of the kind of society our founders envisioned. College participation rates have been generally increasing over the past decade. This is true for students from all income levels. The increase in the participation rate between 1979 and 1994 for the lowest income-quartile—those with annual income of $22,000 and below—was 13.6 percent, while the upper income quartile—those with annual incomes of $67,000 and above—increased their rate by 20.5 percent. The bottom quartile's increase from its low participation rate below 40 percent in 1985 to almost 60 percent in 1994, though not as large as that of the upper quartile, is still the clearest evidence that need-based aid and low tuition are a powerful combination of policy tools. We can take pride in what we have managed to achieve thus far. That we may have failed to fully concretize the ideals of broad and open access to college does not make the efforts we have undertaken any less valiant. As with all ideals, the goals are there as beacons intended to guide our efforts. So long as we persevere, so long as we focus on what needs to be done, and so long as we take step after step in the right direction, we can be certain that the goal is not an illusive mirage, but a tangible possibility that we may some day actualize. Let me then examine where we have failed, for we can learn as much from our failures as we can from our successes.

The principle of low tuition as the best guarantee of equal opportunity is under severe stress in virtually every state. I hasten to add that tuition at public institutions continues to be the best bargain in our economy. Average tuition at AASCU institutions for state residents was $2,772 in academic year 1994–95. But the trend toward higher tuition costs at state institutions is disquieting indeed. The root cause of escalating public sector tuitions is the budgetary pressures faced by states, which have had to devote increasingly higher shares of their resources to Medicaid, prison construction and law enforcement. At the same time, federal need-based grant programs, which are subject to annual appropriations pressures, have steadily eroded in purchasing power over the past decade and a half, while student loans—the only entitlement student aid program—have filled the gap.

The net impact of state and federal actions manifests itself in two already palpable outcomes:

First, while the compelling value of college education has motivated Americans of all economic backgrounds to attempt to participate in higher education, the most needy families have financed the costs through increased borrowing. As a result, students from low- and middle-income families have continued to go to college at increasing rates, but they have also borne the brunt of the escalating burden of student indebtedness. If this trend continues, at some point in the future, the debt service on student loans will offset the economic gains of a college degree, and neutralize the class-mobility that education currently provides so effectively.

Second, we have created enormous anxiety about college affordability for our low- and middle-income citizens. This anxiety about ability to finance college education could have dire consequences in terms of actual participation. We may well be on the verge of losing the gains of the recent past, especially in the case of low-income students, who are, not surprisingly, most sensitive about cost. Even at this very moment, when the upward college participation trends give us hope, The college participation rate for children of families with annual incomes of $22,000 and below hovers at below 60 percent. This is in contrast to the nearly 90 percent participation rates for children of families with annual incomes of $67,000 and above. More ominously, the baccalaureate completion rates for the two groups has been calculated by one analyst to suffer a nearly ten-fold disparity.

SUMMARY OF PROPOSED INITIATIVES

It is in the backdrop of the mixed picture painted by these statistics that I should now turn to the various tax proposals this Committee may examine. The most prominent, and by far the largest, set of educational tax proposals put forth thus far comes from President Clinton, who has called for a series of new initiatives in support of higher education. The President deserves enormous credit not only for having identified the problem of access to higher education, but also for his leadership in providing a remedy of sufficient budgetary magnitude to give us cause for optimism that we could indeed fulfill our dream of equal educational opportunity for all Americans. We are most appreciative of the fact that the President has put forth a budget proposal that would, by 2002, provide more than double the amount of federal investments in student aid than was available in 1993. The President's overall higher education plan includes not only the new tax incentives that this Committee will review, but also contains significant increases to existing discretionary need-based student aid programs. In terms of magnitude, however, the tax proposals before this Committee constitute by far the larger portion of new federal resources that would be deployed in support of higher education. This is in itself another major contribution for which the President should be recognized. The vicissitudes of the annual appropriations process have in general worked against adequate student aid funding, and, therefore, against our nation's long-term economic well-being. The President's call for the use of the tax code to deliver some $36 billion in new resources over the next five years is a bold and decisive step in the direction of building a more comprehensive national strategy of greater human capital investment. I certainly believe that under your leadership, the Committee will also see fit to rise to the challenge of using its jurisdiction to help American families prepare themselves and their children for another century of American world leadership.

The President's proposals include the following new initiatives:

• "Hope Scholarships"—This proposal, named after the state of Georgia's HOPE scholarship program, would create a new non-refundable tax credit of up to $1,500 for the first year of at least half-time postsecondary study in a degree or certificate program. The Hope tax credit would be phased out for single filers with annual incomes of between $50,000 to $70,000, and for joint filers with annual incomes of between $80,000 to $100,000. The tax credit would only cover "out-of-pocket" tuition and fees, i.e., tuition and fees minus any federal, state or institutional grant aid. Furthermore, students' tax credit would be reduced dollar-for-dollar by the amount of any other federal grant aid they receive. The Hope tax credit would be available for a second tax year, provided the student maintains a B-grade (defined as a 2.75 Grade Point Average on a scale of 4) and remains "drug-free."

• Tuition Tax Deductibility—This initiative, a modified version of the original "Middle Class Bill of Rights" calls for "above-the-line" tax-deductibility of college tuition and fees, up to a maximum of $5,000 per tax return for the 1997 and 1998 tax years, and a maximum of $10,000 per tax return thereafter, with inflation indexation. The income phase-outs for tuition tax-deductibility would be the same as Hope tax credit phase-out levels. Tuition tax-deductibility, however, would be available for all students regardless of grades.

• Loan Forgiveness Tax-exemption—This proposal would exclude from taxable income the amount of any loan forgiveness received from educational and charitable organizations in exchange for community service. It would also exclude from taxable income the loan forgiveness granted to borrowers who, after repaying their student loans through the income-contingent repayment option for 25 years, receive forgiveness of their outstanding balance.

• Tax-Free Education Savings—The President proposes an expansion of eligibility for Individual Retirement Accounts (IRAs) to families with incomes of up to $100,000, and would allow penalty-free withdrawal of such IRAs for educational expenses. This will promote greater savings for college.

• Employer-provided Educational Benefits—This proposal extends the current (Section 127 of the Internal Revenue Code) exclusion from income of employer-provided educational benefits through December 31, 2000, and re-instates the eligibility of graduate education for this exclusion.

Mr. Chairman, I would like to express my unqualified support for the last three items on the list enumerated above.

The exclusion from income of loan forgiveness is particularly appropriate in that it removes what is clearly an unintended impediment to public service. Modifying the tax code to encourage, rather than hinder, volunteerism and public service strikes us as an especially effective means of lessening the impact of high college debt on graduates' career choices.

The President's call for expanded use of IRAs is equally as effective in encouraging and empowering American families to save for their children's education, and could go a long way toward reducing the over-reliance on loans.

The extension and expansion of non-taxability of employer-provided educational assistance is another important means of improving the skills and productivity of our workforce, and I would encourage the Committee to examine this important provision not only for purposes of extending it, but with an eye to making it a permanent provision.

Expansion of IRAs and extension of Section 127 benefits are both included in S. 1 and S. 12, the two leadership bills introduced in the other body. This indicates broad bi-partisan support for these two particular approaches to using the tax code in support of higher education, and I hope this Committee will also find them worthy of its support.

OUR VIEWS ON PROPOSED TUITION TAX DEDUCTIBILITY

In contrast to the these latter initiatives, the first two items on the list, i.e., Hope tax credits and tuition tax deductibility, require significant modifications before they can be justified in terms of educational policy. Indeed, tax deductibility of tuition is beset with so many problems that we propose that it be replaced with a different provision altogether. I re-iterate that this is not a judgment on our part as to whether certain middle- and upper-income taxpayers—specifically, those with children in college—deserve tax relief in the abstract. Rather, the question is whether these particular proposals can help us fulfill our goal of expanded access to higher education.

The proposal for tax deductibility of college tuition, when subjected to this test, clearly fails to promote the outcomes that it may, on first glance, seem to promote. The reasons for this judgment on our part are three-fold:

• Because of the progressive nature of our tax structure, tax deductions, even if they were for the same dollar amount, would generate individual benefits that are inversely proportional to income. In the case of the proposed deductibility of tuition, this means that for taxpayers in the upper end of the eligible income scale, the marginal value of every dollar of deduction is 28 cents, in contrast to those closer to the lower end of income-scale, for whom it would be worth 15 cents, not to mention the very neediest families, for whom it is worth literally nothing because they have no tax liability. This unfortunate feature is, of course, endemic to our progressive income tax system, and would be found in all tax deductions, including some that AASCU supports. The regressivity inherent to all tax deductions, however, is amplified in the case of tuition tax-deductibility because of its other features, as you will see below.

• The second contributing factor to our reservations about the tax deductibility of tuition and fees is that the proposal, as currently configured, would reduce the allowable deductible expenses in a dollar-for-dollar fashion by any grant aid received by students. By allocating all grant dollars toward tuition first—instead of allocating them in proportion to relative costs of tuition and fees versus other educational expenses—the proposal shifts substantial subsidies away from the recipients of

need-based student aid, and exacerbates the regressive effects due to the structure of our marginal tax rates.

• Finally, the proposal offers the same theoretical opportunity to deduct up to its maximum amounts (of $5,000 and by 1999, $10,000) to all taxpayers. But, in reality, not all taxpayers would be able to avail themselves of the deduction equally. This is because our lower income citizens tend to be disproportionately concentrated in lower-cost institutions.

Allow me to illustrate the interactive results of the three causes by a comparison. Our nation's public black colleges are among the most important points of access for minority students. Median family income at these institutions is about $27,000 per year. A student from a family with $27,000 of annual income at these institutions would confront a total cost-of-attendance of about $9,000, of which about $2,700 would be for tuition and fees. Assuming an average Pell grant award of $1,500 (based on the President's proposed Pell grant maximum of $3,000), this student's family would receive a reduction of less than $200 in their taxes as a result of tuition tax-deductibility. Contrast this with a family with the characteristic $73,000 median annual income at our more expensive universities. Such a family, because they could avail themselves of the maximum deductibility, and because they realize a gain of 28 cents per dollar of deduction, would receive tax benefits of $1,400 when the maximum allowable deduction is $5,000, and $2,800 when the proposed maximum of $10,000 takes effect.

Mr. Chairman, the example I just provided should not, in any way, be construed as implying our opposition to the latter example's effects in terms of tax relief. Rather, our misgivings have to do with the disparity between the benefits the two families would receive. The targeting of the proposed tax benefits, as shown in this example, bears an inverse relationship to where federal dollars would produce the greatest net national gains in college attendance. Families in the upper-income quartile already participate in higher education at near-saturation rates. College participation rates for children from families at or below the national median family income (about $40,000) could, on the other hand, be dramatically increased through better targeting of this proposal at them. Two important changes could substantially improve this proposal:

• The formula for determination of allowable expenses should be changed from the proposed "tuition and fees minus grants" to "cost of attendance minus grants." Cost of attendance is defined by Congress in current law, HEA, Title IV, Part F (20 U.S.C. 1087qq).

• To offset the increased federal cost of broadening the definition of allowable expenses, the maximum deduction could be reduced.

These two changes, while still not providing new educational benefits to our lowest-income citizens, would better focus this proposal on moderate- and middle-income Americans.

An Alternative Policy Option

Alternatively, the Committee may wish to substitute tax deductibility of student loan interest payment for deductibility of tuition. Such a substitution would, in effect, treat loan financing of investments in higher education the way home mortgage loans are treated under current tax law. We believe the very same logic that led Congress to create deductibility of home mortgage interest instead of deductibility of purchase price of homes applies in the case of higher education. AASCU supports an "above-the-line" deduction of up to $2,500 of annual student loan interest payments with income-phase outs similar to the Administration's proposal. Our proposed substitution has several important advantages, and I should point out that slightly different versions of tax deductibility of student loan interest payments are included in both, S.1 and S. 12.

• Because our most affluent citizens do not need to borrow, deductibility of student loan interest automatically shifts its subsidies toward the children of low- and middle-income families who had to finance college through borrowing.

• The benefits of interest deductibility are spread out over time, and would mitigate some of the ill effects of the student indebtedness on our economy. The adverse effects of college debt on career choices would be reduced. In addition, the savings realized by heavily debt-ridden graduates would enable them to participate in our economy in all of the advantageous ways that previous generations of graduates have.

• Because of the delayed and incremental nature of student loan interest deductibility, it would certainly not have the potential inflationary consequences that some have attributed to tuition deductibility. In addition, because the federal government

itself sets the interest rate for student loans, the deductibility of interest payments would not result in higher rates.

• While the deductibility of tuition would do very little for graduate education, the deductibility of student loan interest would immediately become the largest form of financial aid for financing graduate study. As you are aware, student loans are the only broad-based form of financial aid for graduate students. While the federal government has a variety of small categorical grant and fellowship programs for graduate students, there is no analogue to Pell grants for graduate school. Because graduate students, while they are in school, tend to have very low annual incomes, the deductibility of tuition would provide only marginal benefits for them. The deductibility of student loan interest, on the other hand, precisely because it is better timed to provide steady relief over time, can provide a powerful incentive for more of our citizens to engage in graduate and advanced studies.

• A larger number of our citizens would benefit from a properly configured student loan interest deductibility provision than would from tuition tax deductibility.

OUR VIEWS ON HOPE TAX CREDITS

Mr. Chairman, allow me to now turn to the Hope tax credit proposal, and share AASCU's views regarding that initiative with you and the Committee.

As I have already mentioned, in calling for higher education tax credits, the President has proposed a major new mechanism of delivering new federal resources in support of higher education. The President has identified a new means, i.e, the use of the tax code, to realize a worthy goal, broader access to college. AASCU members enthusiastically support not only the President's stated goals, but his proposal that tax credits would be a powerful means to that end.

At the same time, however, we share the concerns of our colleagues regarding the details of the proposed tax credits.

• AASCU views the decision to turn what was originally a refundable tax credit into a non-refundable one as a step in the wrong direction. This change specifically channels the benefits of Hope tax credits from Americans for whom it could do the most good in terms of access. The difference between refundability and non-refundability is that the dollar amount of a family's tax liability becomes the de facto cap on its eligibility for benefits. If our goal is to open the doors of college to more Americans, our national self-interest would argue for the inclusion of our neediest citizens.

• As is also the case with the proposed deductibility of tuition, the Hope tax credit would also be reduced in a dollar-for-dollar fashion by the amount of other federal grant aid received. Ironically, the effects of this "netting" of federal grants against Hope credits is even more drastic than would be the case for tax-deductibility. Netting against a deduction results in a loss of eligibility equal to the applicable marginal tax rate. Netting against a tax credit, on the other hand, results in a loss of eligibility equal to the amount netted. In the case of the example I used earlier, if the student were a freshman, the family's loss would equal $1,500, because the receipt of $2,000 of Pell would completely eliminate all eligibility for Hope tax credits. This family would therefore have no option but to take the deduction, which, as we saw, generates $113 in benefits. The student from the family with the $73,000 annual income would be eligible for the full Hope tax credit of $1,500. Such a student's family would fare better with the Hope scholarship while deductibility is capped at $5,000, but could do better still once the proposed maximum of $10,000 is reached.

• The use of the B average is troubling because it further magnifies the overall regressivity of the proposal, and because it would promote outcomes other than what it is apparently intended to promote. First, students from at-risk backgrounds tend not to be as academically well-prepared as those from upper-income backgrounds. This is also generally true of first-generation college students and students who were raised in non-traditional families. Second, needier students, fearing loss of Hope eligibility, would be more likely to avoid more difficult courses in favor of less challenging work, intended solely to ensure a second year of Hope eligibility. Much better results would ensue if the current federal eligibility standard of "satisfactory academic progress" were substituted for the proposed grade requirement.

These concerns can be addressed by the Committee in a manner that would fully realize our common goal of greater educational opportunity for all Americans. A refundable Hope tax credit, without the federal grants offset contained in the proposed version, would be giant step in the right direction. Mr. Chairman, we stand ready to work with you and the Committee in any way we can to assist you with the historic task before you.

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Mr. HULSHOF. Let me begin the questions. Mr. Appleberry, you hit upon a point about which we had much discussion with Secretary Rubin when he was in front of us on February 11.

Concern was expressed that, first of all, the $10,000 deduction probably would be most used by higher income families. Is that consistent with your testimony and your belief?

Mr. APPLEBERRY. Yes, sir.

Mr. HULSHOF. And in addition, that the $10,000 deduction, which did not have a corresponding grade requirement, which we will get a chance to visit about in a moment, but that this seemed to be a discriminatory imposition in that the $1,500 credit, which would be used by low-income families, has such a requirement.

Is that also your belief, that——

Mr. APPLEBERRY. There is no current requirement of B average for the deductibility proposal. In fact even if there were, the probability would be that its impact would not be as regressive in the deductibility proposal because that proposal would likely affect more highly supported students anyway. They are usually more prepared to go to college.

Mr. HULSHOF. Mr. Ikenberry, in your written statement—and I think each of you in either your testimony or your written statements, talked about the B average, which we will talk about a little bit.

But in addition to your statement, Mr. Ikenberry, you talk about the confidentiality of student records.

It is my understanding that in order to protect student confidentiality, that schools, colleges, universities are not allowed or permitted to disclose grades to their parents, is that true?

Mr. IKENBERRY. Yes, that is not only institutional policy, but that is Federal law. But I think just as a matter of philosophy, it is of concern to us to link confidential student records, including academic performance, and a Federal definition thereof, because ultimately I think we would be led toward a Federal definition of what constitutes a B average in the first place.

I think that beginning to move down that line causes all of us here at the table, and virtually all of our institutions across the country a great deal of discomfort, and concern as to where we would be headed and what the implications of that would be.

Mr. WADDLES. Mr. Chairman, if I could add to that.

Mr. HULSHOF. Yes. Mr. Waddles.

Mr. WADDLES. The concern that we have is some of the testimony you have heard today concerning the variety of situations that schools find themselves in on grading, on no grades, on whatever the situation is, that overlay that must take place to decide who is making satisfactory progress.

Ironically, today, I have had a report given to me that there was testimony given over on the Education and Workforce Committee concerning that very issue and there was additional talk from the Department of Education concerning other ways, whether it is going to a C or whether it is going to a satisfactory progress measure or other things that Members were putting on the table.

All of that I think adds to the complexity of this matter. Given the fact that this regulation will come from not only the Department of Education but also the Department of the Treasury, and maybe it was only myself that was taken aback a little today—and I am supportive of many provisions that we are moving forward with—but the fact that it was Treasury at the table, then Education came to the table later, giving testimony today. There are symbols that we look for, and I have been in that position of trying to deal and negotiate with that.

But it is something I think that gives us pause as we would wait to see what kind of regulation would come forward.

Mr. HULSHOF. Anyone else on that issue?

I have tossed this one out to each panel so far and would welcome each of you to respond as far as additional administrative costs, assuming that the grade requirement or the drug-free policy, tags along with these proposals into passage.

Are there going to be administrative costs? If so, are they going to be significant? And if so—I guess a three part question—who is going to bear the costs of those additional administrative costs? Any of you.

Mr. Ikenberry.

Mr. IKENBERRY. I might take a pass at that. I think that if the B average requirement were eliminated or modified simply to be the normal academic progress rule that is generally applied for all other student aid—if that single provision could be eliminated from the proposal, it would reduce very, very substantially the amount of administrative burden that would fall on most of our institutions.

I think as colleges and universities across the country work to hold down costs and at the same time improve quality and access, the impact of Federal regulations is an increasingly significant problem, and here I think we have an opportunity to look at that in advance and try to minimize that burden.

Mr. APPLEBERRY. Let me try and answer as well because I have been here and heard the question raised with other panels as well. Part of the difficulty we have in being directly responsive to requests is, we do not know what they are going to try to do to implement the program, and it is difficult to assess costs unless you know who is going to be responsible for enforcement, what the provisions or processes are going to be and how that is going to be handled, both in terms of timing and in terms of who is responsible.

When we push on that, we cannot get a good answer.

Right now they tell us, well, we really do not know yet, but trust us—we are going to reduce that burden.

It could go all the way from being an extremely expensive and not very well-timed, in terms of delivery of services kind of program, to one that might not involve colleges and universities in the verification at all, and it could range anywhere along those channels and we simply will not know until they tell us what they plan to do by way of enforcing the regulations.

Mr. WADDLES. I think there is an additional administrative burden that we may be overlooking a bit and that is, if the B average is there, there will be the administrative burdens that come with

the complexities of the regulations and how we follow through with that. And today there was a comment that it would be a big pencil, at one point there was a comment made. But the other is that if it goes forward, and that is part of the tools that we will be using to help finance education for individuals, there will be an administrative burden on the schools and the communities at large to educate the individuals about how to use that tool, about how to follow through with it, about using the tax system to make sure that they are aware that this is available, and that will carry with it its own administrative challenge, because it is something that, as the numbers reflect, not as many people will use as we anticipate.

And if it is the tool that is left, it is our burden, our challenge to make sure that we get as many people using it as we can so that they can have the hope for the education.

Mr. HULSHOF. Mr. DeNardis, you wish to weigh in on this, please.

Mr. DENARDIS. Yes, with one additional point.

With respect to the B average, the biggest issue is not administrative cost. Clearly, there will be some, to what extent, hard to determine at this point.

I think the other issues that have been discussed today are really the critical issues, and let me underscore one that may or may not have been touched on before I got here, and that is the question of equity. In my formal testimony I cite U.S. Department of Education data with respect to academic performance by race and ethnicity, and it shows, and I will not go through it—but it shows that there are wide variances.

The National Postsecondary Student Aid Study shows that a high proportion of students earning a 3.0 cumulative grade point average, or higher, ranged significantly between the various racial and ethnic groups.

Clearly, an indication, at least at the start of the college years, that background and familial experience, quality of schools, and so on, up to that point have an impact on academic performance, at least in the first year or two.

I can tell you, from an institution that has a growing number of minority students, and students of color, that many of them who have come in from high school years where they were uncertain about what their future would be after graduation, if graduation, and once they make a decision to go to college and choose the local college, they do so hesitantly, and not confidently.

Their first year is difficult, in some cases; not in all cases. But in many cases. The transformation, however, from the first year to the upper class years and graduation is phenomenal, and while some of these students may have come in and are performing at a 2.4, 2.5, 2.6, 2.7 level in year one and two, many of them, most of them, in my experience, improved dramatically, and by the time they are juniors and seniors are doing significantly better.

They have found focus in their lives, they have found a mission, and a major, which they hope will bring them a successful career, and it makes all the difference in the world. So it is unwise to judge them, in my view, in the freshman year.

Mr. HULSHOF. Mr. DeNardis, let me shift gears just a little because you spoke very eloquently and passionately about section

127, and I want to ask you, are you concerned about investing limited resources to implement, say, this program to the year 2000, or December 31, 2000, only to see it terminate at that time? Is that a concern you have?

Mr. DENARDIS. Oh, it has been one of the banes of my existence for the last 6 or 7 years, not knowing how to plan from an institutional point of view. You know, we have 6,000 students at our university. More of them are part-time students than full-time students. Many of them are working professionals at the graduate level.

There is much uncertainty in their lives about 127 being on-again and off-again, and I can tell you, this raises havoc with our budgets as we plan from 1 year to the next.

Let me tell you, quite frankly, what havoc was rained upon us last year, with first, the gridlock and then the extended period of time before this issue was resolved.

We had a large exodus of students in the spring, and the summer, because they felt that this impasse, that is, last year's, was different from the impasses of previous episodes, and they weren't quite sure how it was going to play out.

Now, a lot of them have been going to school for 6, 7, 8, 10, 15 years, and they have been through a couple of cycles of this, and they have seen it expire. They know that the word is that it will be reinstated and they get reasonably good word from, I hope their institutions, and in our case, from my office, about when this might occur.

But I must tell you, last year, I could not speak confidently about what was going to transpire here and I say that as someone who formerly served here. So we had, at that particular level, the part-time level, and particularly in the graduate school, since our graduate school is 80 percent part-time working professionals, problems that we had to deal with.

And fortunately, we did deal with them. But it is not our problems at an institutional level, that I am concerned about. It is the uncertainty in their lives, and, you know, they go very diligently at the graduate level, trimester by trimester. They are on a target to get a master's degree by a date certain.

They have complications in their working lives. They have complications in their family lives, and this is just another complication that sometimes makes it quite unbearable.

Mr. HULSHOF. Thanks, Mr. DeNardis.

I have some additional questions, but I want to defer to my colleague from Florida, Mrs. Thurman.

Mrs. THURMAN. Thanks, Mr. Chairman.

Mr. Ikenberry and Mr. DeNardis, one of the things that I heard in your testimony was we have a lot of different kinds of students out there, and the way they are having to participate in higher education, with a lot of different other programs that are going on out there. And I think that is true. I think that is one of the reasons why some of these proposals are getting shot at on occasion, because it is hard to put a one kind of size fits all, and I think that is a problem we have here.

And to Mr. Waddles as well, you have a group of students out there that are not going to participate in what we might consider

to be a regular institutional setting, but certainly provide an opportunity into the workplace that is critical in this day and age.

But with that all in mind, unfortunately, we have to come up to some final conclusions here. So, in light of what you have heard in testimony as well, earlier, and I did not mean to leave you out, Mr. Appleberry, I am sorry. If you had to choose, I mean, you heard the last panel that only talked about how we have to expand Pell grants. That is it. You know, that seemed to be the real need out there.

I do not want to get into a situation where we do a piece of legislation that then also leaves out a whole bunch of people out there.

So if you could give us some guidance. If you were going to craft this and you had $40 billion and you wanted to make sure—I know what you are going to say, Mr. Waddles—"Just include us."

If you had that money, and you as the institutions who serve those students, what would be your best recommendation? Forget the President. Forget all of the other speakers. What would you do?

Mr. IKENBERRY. Well, you premise your question with a very, very important point that all of us need to continue to remember, and that is the great strength of higher education in this country is the tremendous range and diversity of opportunity that is out there, and that one size will not fit all, and one single solution will not fit all.

Let me see if I could respond. I think the first priority is to maintain the strength of the system of student aid that has served us so well in the past, and I would join with the panel that commented earlier this morning about the Pell grant.

But I think also it is important to increase the diversity of options that are available to students and families, and that is basically the proposal that you have before you, not just in the Hope Scholarship Program, but in terms of section 127 and the deductibility of student interest in several other proposals that are there, that I think are very appropriately, now, for, really, the first time in front of this Committee in a significant way, that really is precedent setting.

I would encourage you to continue to work with these proposals and to refine them. They are not perfect proposals. I think even those who advance them suggest that refinement is possible, and you have heard, I think, several suggestions from those of us on this panel.

I think the proposals can be improved, but I think we should not lose this opportunity to diversify the range of solutions that are available to students and families, and this will, I think, provide increasing opportunities for students and families to pick and choose, really, the precise financial solution that fits their circumstance and fits their academic objective.

Mr. DENARDIS. Representative Thurman, it is an excellent question. The main theme of my opening remarks, as you will recall, was to build upon the need-based aid programs as the cornerstone.

But I think it is time, now, to range beyond those programs and to broaden the diversity of options as Dr. Ikenberry has indicated.

The Pell grant is, of course, enormously important. There is not a college president in the United States that would not attest to that.

Nearly a quarter of my full-time students have a Pell grant. But let us face it: Pell grants are limited. And you may say, "Well, let us take the wraps off the limits."

But you have got to understand what that will cost. I mean, right now, the limits are, for all intents and purposes, for a family of four, earning at about $27,000 or $28,000, as they go beyond that they are out of the range. OK. So if you are earning $30,000, which is not a princely sum of money, you are beyond the Pell grant range.

All right. So what do we do to expand and strengthen Pell? Very costly. The President has recommended a good and important step. I believe that to go much beyond that, there are practical legislative and budgetary problems that must be confronted.

For every $100 increase in the Pell, we are talking about $300 million. If we were to bring it up to $5,000, as was suggested by someone on the prior panel, we are talking about $6 billion more—$6 billion more. Can it be done? Well, as a matter of fact it cannot be done.

It cannot be done unless you change the caps. You have committed yourselves to caps in 1993. Those caps extend through, I think, fiscal 1998. There are fixed caps on domestic discretionary spending. So you could not do it anyway under those caps.

You may not even be able to do the President's proposal under those caps until you renegotiate them.

So, from a practical point of view, the talk about significant expansion of Pell beyond what the President has already suggested is probably out of the question.

Therefore, I think you have to look practically at other ways to deal with the problem, and I think basically, the administration has done that. They have found another way to increase and expand the options.

Mrs. THURMAN. Thank you. Mr. Appleberry.

Mr. APPLEBERRY. Mrs. Thurman, fortunately, the choice really is not there with this Committee, between the Pell and the Tax Code. One of the things that I mentioned in my testimony was commending the President and the Congress for looking at the Tax Code as an additional opportunity to provide access to education on the part of many of our citizens.

So this Committee is, indeed, dealing with the Tax Code and is not in a position to deal with Pell. So I do not see that as a tradeoff in terms of a decision before the Committee.

But even if that were to be the case, and you all interact with the Committees that are dealing with the Pell, the facts are that the proposals before the Congress now would increase Pell by $300 per student, eligibility, and the cost is $4 billion.

That would help primarily people, $27,000 family income, and below. We have $36 billion in the proposal before this Committee in tax forgiveness that would hit primarily people in the $45,000 tax range, and above.

Those tradeoffs seem to be somewhere inappropriate, if we are really trying to magnify access for students in American higher education.

Mr. WADDLES. And if I could. I appreciate the inclusion reference, but I think the issue really comes to this Committee, this

Congress, the administration setting the priority as to what that audience, that targeted audience is.

This is the same debate that we went through in the last reauthorization of the higher education, and the one before that. The last time, going through, we debated the issue of having a Pell entitlement, and we actually succeeded, through the Committee, of having a Pell entitlement because of the critical nature of that population.

Here we have before us in the testimony that we heard today, there seems to be an appearance of a balancing act. It is attempting to be placated in this process. Having the tax credits and deductions that gives a broader array of tools and a broader array of issues for a higher income level, but will also do as the administration has proposed, a higher Pell grant maximum, whether it goes to 3,000, or somewhere higher.

This, again, as Dean Breneman referred, back to 1978, was the paradox that the Committee and the Congress placed itself in at that time. A Democratic-controlled House moved the tax credit issues. A Republican-controlled Senate moved an increase in Pell and a broader loan program.

A President put forward the idea of a middle-income student loan program, which was later brought back again in the 1992 amendments of higher education.

All of that was laid on the table, everything was moving forward, we wanted to do it all because we wanted to address the entire population. We were unable to do it. It is ironic that we are in the shadow of the balanced budget debate that goes on while we are doing this, and the amounts of money that we are talking about. But my fear is that as you set priorities here today, and in the next few months, that at the end of the day, at the end of that budget cycle and that budget process, and Chairman Kasich and Chairman Domenici are negotiating those final days, that one of these provisions is lost, and that balancing act that we have attempted to create fails.

And so, again, it falls to what is the audience we want to target with this, and then zero in on that. If it is the most at risk, the most at need, then there are ways to do it, and some of those are the section 127, and other elements, that can access that doorway for them.

If it is not, if it is a broader array of tools, then let us go after that. Let us just not try to paint it all ways, for everybody.

Mrs. THURMAN. I, quite frankly, think that those that want to go should have that opportunity and that is why I bring up that issue.

I think that that is what this is about, and if we can provide that opportunity, whatever that broad-based tax incentives, Pell grants, scholarships, whatever it might be.

Quickly let me ask you this. Mr. DeNardis made a statement within his testimony. As the availability of Federal student grant aid has decreased, the rate of tuition growth has increased. And then vice versa. As the Federal student grant aid increases, tuitions either remain the same. Do you all agree with that statement?

Mr. IKENBERRY. Yes, I do. The data that I have seen supports that, and I think for those of us who have actually worked on a

campus, we actually experience that in real terms. When the Federal Government either has to cut back, or the growth in student aid does not keep pace, it obviously puts more pressure on institutions to increase institutional aid, or State budgets to increase State aid. Either way, that directly or indirectly has an upward pressure on tuition.

So yes, I think that increased student aid from the Federal Government is the friend, the ally, in terms of moderating tuition increases at the campus level.

Mrs. THURMAN. I found interesting the dialog on the cost-shifting issue. I was not sure that I totally understood cost shifting in the educational institution as you might think of it in health care, because generally speaking, you have tuition that is set, you have financial aid, you have people basically pay the same fees. Everything else.

But the biggest cost shifting I have seen over the years has been the difference between an in-state student and an out-of-state student as being the real difference in tuitions within a school system.

But I bring all this up because I am very concerned. We see the dollars, not only here, but also in our State legislatures. Florida and California are the first States, in the last year or so, that are now spending more on prisons than they are on higher education.

That is a very sad number for this country, and for our two States to have reached. That magnitude, where we are actually spending less dollars on educating students. And that is why I would hope that what we do is offer more opportunity to those that want to, no matter what it is they are looking for. I think that is extremely important.

Mr. DENARDIS. The cost-shifting discussion that you heard by the prior panel of economists—and I am not an economist although I think my bachelor's degree was in economics.

Mrs. THURMAN. Well, mine was a middle school math teacher, so——[Laughter.]

Mr. DENARDIS. The medical marketplace is decidedly different from any other marketplace in the United States, although it is beginning to change with managed care. I do not want to get into a debate here on managed care.

Mrs. THURMAN. Let us not do that. [Laughter.]

Mr. DENARDIS. But the old medical marketplace that gave rise to cost shifting was a marketplace where the laws of supply and demand were upside down. They operated in an inverse relationship, unlike the rest of the marketplaces of the United States. Therefore, cost shifting was not only possible, but highly likely as a result of that.

I do not think you can transfer that into any other marketplace. You cannot do it in the marketplace of higher education.

Mrs. THURMAN. Last comment. I agree with you on the B issue. I think that we have so many scholarships, local communities that give out to the highest students. There are actually hundreds of thousands of dollars, millions of dollars that are being given by private organizations today, that go to the top 5 percent, top 10 percent of our student population. Who we actually lose are those that potentially do not have the computers at home. They have the ability, have everything going for them, but just have not been given

the opportunity. They maybe have to work and so do not have that extra hour to do an extra report, or whatever it might be to keep that A up.

And the second thing I would say is be careful for what we wish for. We see it as they leave their senior year. They are not always taking the highest level courses. They are looking to bring their grade average up, and by that, we actually bring their course levels down.

And we have to be extremely careful in that debate, and not to pull students down into a situation where they do it for a grade and not for an education.

Mr. HULSHOF. Thanks, Mrs. Thurman.

The hour is late. Let me just finish with just a couple of quick questions.

Mr. Appleberry, hopefully one of these questions will touch on your last comment.

Mr. Ikenberry, you mentioned, and recognized in your testimony the significant expansion that the Federal Government, particularly within the Tax Code, or with the administration's proposals, and there has been a lot of discussion about the Georgia Hope scholarships. In fact in the State of Missouri, our Governor has just proposed Challenge scholarships.

Do any of you happen to know how many similar type scholarship programs there are across the country?

Mr. IKENBERRY. I cannot speak authoritatively to that. Maybe my colleagues can. I did visit the Georgia program and I know that there are several other proposals, I believe even maybe in the State of Maryland, and elsewhere around the country. But I believe, to the best of my knowledge, the only one that is really operative right now is in Georgia.

Mr. HULSHOF. How is that going to work, or is that something that will be incumbent upon State legislatures to decide? If the administration's proposals are to be enacted, then are we going to have duplication, or——

Mr. IKENBERRY. Well, there is a fundamental difference with the Georgia program, with all of its strengths, that I think needs to be brought out here. That is, the Georgia program is really not a tax program, either a tax credit or a tax deduction. It is an outright direct grant from the State of Georgia to the students.

Therefore, I am sure that if this program were adopted, federally, it would likely cause some reexamination of the Georgia program. But it is not as if we had a Federal tax incentive program laid on top of a State tax program.

I think the Georgia program is quite different in that respect.

Mr. WADDLES. And there is the exclusionary language that, if you are receiving other grant money, that is offset against what you are receiving on the tax side. So that is where, in effect, they are trying to recognize the Georgia situation.

Mr. HULSHOF. Mr. Appleberry, I will give you the last word, because you wanted to comment, I think, as Mrs. Thurman was concluding.

Mr. APPLEBERRY. Yes, and I am sorry she has left, because I wanted to correct what might be a misimpression on the Committee's part.

The cost pressures related to financial aid do not operate at the public universities. That is primarily in the private sector because that is where the cost shifting occurs.

The tuition levels that are set in the public sector are usually more related to the amount of appropriation that we get from the legislatures in the State, and not in terms of source or availability of student financial aid, and I think that needs to be made clear.

One last comment on your last question.

Mr. HULSHOF. Yes, sir.

Mr. APPLEBERRY. Georgia is the only one that has such a program operative now. It is interesting that in a recent meeting of university presidents that I conducted, where we were looking ahead, that there were about seven of the presidents there who said that their Governors were asking them for ideas of what they could do to be known as the Education Governor, so they could be like Governor Miller in Georgia.

The problem is funding that scholarship. Georgia took a one-time tax lottery situation and made it guaranteed to help their students. That opportunity is not available to very many States.

Mr. HULSHOF. With that, gentlemen, and if there are no other questions by any Members of the Committee, we thank you for your testimony. This hearing stands adjourned.

[Whereupon, at 4:23 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Hon. David A. Longanecker, Assistant Secretary, Postsecondary Education, U.S. Department of Education

Mr. Chairman and Members of the Committee:

I am pleased to submit this testimony to you on the Administration's postsecondary education tax initiatives. Our discussion comes at a time when, more than ever before in our history, education is the fault line between those who will prosper in the new economy and those who will be left behind. We know that most of today's good jobs require more skills and training than a high school diploma affords. Effective and accessible postsecondary education is critically important both for individuals and for the strength of America's economy and democracy. That is why President Clinton made excellence in education our national mission in his State of the Union address, and why he has issued a bold "Call to Action for American Education in the 21st Century."

Our Nation faces great challenges when we strive to ensure access to effective education. In the next decade, increasing numbers of high school graduates will significantly expand demand for postsecondary education. More and more older students will return to college to get the education they need to succeed in the new economy. And a growing population of disadvantaged students will need financial and other kinds of support.

Over the past several decades, the Federal government has firmly established its commitment to ensuring access to effective postsecondary education—but we have an unfinished agenda. We must do more in order to meet the challenges of the twenty-first century.

We believe that we can best address our commitment to higher education and the challenges we face with a comprehensive, three-pronged agenda made up of our tax initiatives, fiscal year 1998 budget proposals, and our proposals to reauthorize the Higher Education Act. The tax and budget proposals have been described in our budget documents, and our proposed bill language will be provided shortly. We hope to share the HEA proposals with Congress this spring. These three components, which we propose in the context of a balanced Federal budget, form our coordinated higher education strategy for the twenty-first century.

TAX PROPOSALS

Our tax initiatives are designed to assist students and families and to encourage postsecondary education. We believe that these proposals will effectively complement the traditional student financial aid programs. The tax proposals are criti-

cal to our goal of establishing a national ethic of learning to high standards and a national expectation that at least two years of education after high school is the norm for which all students should strive. We want to make at least 14 years of education the standard in America.

Our HOPE Scholarship proposal, modeled after a successful program in Georgia, would provide students who are enrolled at least half-time and have no prior drug-related felony convictions with a maximum $1,500 tax credit for tuition and required fees for their first year of postsecondary education. Students would receive another $1,500 for the second year if they stayed drug-free and earned at least a B minus grade point average. This credit would put $18.6 billion in the hands of students and their parents over the next five years. It would help 4.2 million students in 1998 alone, allowing them to pay the equivalent of the full cost of tuition at a typical community college and encouraging them to work hard and achieve excellence.

In 1998, 8.1 million other students would have available to them a $5,000 tax deduction for higher education expenses. The deduction would increase to $10,000 beginning in 1999. Families would save $17.6 billion over the next five years with this deduction. Because the credit and the deduction are designed to help middle-income families pay for college, eligibility would be phased out for families with incomes between $80,000 and $100,000, and for individuals with incomes between $50,000 and $70,000.

We must also do more to encourage families to save for their children's education. That is why we have proposed greater flexibility in using Individual Retirement Accounts so that funds saved in these accounts can be used for postsecondary education expenses, free from early withdrawal tax penalties. In addition, we have proposed an expansion in eligibility for tax-deductible IRA contributions. From 1997 through 1999, eligibility would be phased-out for families with incomes between $70,000 to $90,000 and for individuals with incomes between $45,000 and $65,000. Beginning in 2000, the phase-out ranges would match the ranges of the proposed tax credit and deduction. This expansion would double the previous eligible income levels. Families who save through an expanded IRA and then use the savings for higher education could deduct up to $10,000 of their withdrawals a year, making savings for college virtually tax free.

We also suggest several smaller but important tax incentives. We propose extending the tax exclusion for employer-provided education assistance of up to $5,250 for both undergraduate and graduate students. In addition, for 1998–2000, small businesses would be given a new incentive to provide educational assistance to their employees. Employers would receive a ten-percent tax credit for amounts paid under an employer-provided educational assistance program for education provided by a third party. The President's budget also provides tax relief for loan forgiveness so that students whose loans are forgiven by charitable or educational institutions in return for a community or public service commitment, and borrowers whose Direct Loans are forgiven after 25 years in the Income Contingent Repayment plan, are not taxed on the forgiven loan amount.

Our tax initiatives are designed to benefit working families who are struggling to pay for college. Since 1979, the bottom three quintiles (fully sixty percent) have seen only modest growth in their real incomes. Over that same period, college costs increased by 165 percent. It is no wonder that so many middle-income families are worried about their financial circumstances and wondering how they are going to pay for college.

Moreover, evidence tells us that we need to improve access to college for both low- and middle-income students, who have much lower rates of participation in postsecondary education than higher-income students. In 1994, only 45 percent of high school graduates from low-income families and 58 percent from middle-income families went directly to college, compared to 77 percent of students from high-income families.

We also believe that our tax initiatives will improve college completion rates, as grants do. Ensuring initial access to postsecondary education is not enough. We want students to complete their education. Our data show that low- and middle-income students are less likely than higher-income students to earn bachelor's degrees within five years, and one of the main reasons that students drop out of college is lack of money. By putting more resources in the hands of students and families, we can help to increase degree attainment. In addition, many adult workers could be expected to return to school on a part-time basis in order to improve their job skills and credentials.

One often overlooked benefit of using tax incentives to provide educational assistance is their predictability. Students are more likely to pursue and complete postsecondary education when they are aware early in their schooling of predictable and

consistent financial aid. Taxpayers who see a specific line item reference to the HOPE tax credit and the deduction on their tax forms year after year will be well aware of these sources of college financing. As a result, we expect to see increases in the participation and completion rates of low- and middle-income families.

Thus, the tax proposals will help working families who are struggling to pay for college. They will improve both access and college completion among middle-income students. They will reward savings and help reduce the need to borrow. And they will encourage adult workers to pursue re-training and life-long learning.

FISCAL YEAR 1998 BUDGET PROPOSALS

We know, however, that the tax code may not be the best vehicle for helping the neediest students, who often do not have significant tax liabilities. That is why we have dedicated ourselves to doing all we can to increase the availability of need-based grants, as well. Our fiscal year 1998 budget proposals are important for this reason. I would like to address them briefly since they complement our tax initiatives. The tax and budget proposals together are integral to our commitment to accessible and effective higher education for all students.

Our budget request would make an unprecedented $47 billion in student financial aid available to some eight million students in fiscal year 1998, with a particular focus on the programs that help the neediest students.

The Pell Grant program is one of our highest priorities, and our proposal would provide nearly $7.8 billion in Pell Grants to four million needy students in fiscal year 1998—and at least $40 billion over the next five years. We would increase the maximum award to $3,000 in fiscal year 1998 and expand the eligibility of independent students. This kind of federal commitment to need-based grants is critical to our goal of enhancing access, for grant support remains the most effective way to ensure access and to encourage graduation among financially disadvantaged students.

Our budget will also make a number of changes in the Federal Family Education Loan (FFEL) and Direct Loan programs that will help the increasing numbers of students who borrow to finance their education. Our proposal would cut fees from four to two percent for need-based loans, and to three percent for other loans—thus saving four million low- and middle-income students $2.6 billion over five years. These fee reductions will put more money in the hands of students when they are paying tuition and other college costs. In addition, because lender costs during the in-school, grace, and deferment periods are very low, our budget would reduce the interest rate during those periods by one percentage point, thereby reducing both Federal costs and borrower costs on unsubsidized loans. We would provide these benefits to students while saving taxpayers $3.5 billion over five years by streamlining the guaranty agency system to make it more efficient and cost-effective and by eliminating excess lender profits.

REAUTHORIZATION OF THE HIGHER EDUCATION ACT

Our tax and budget proposals are designed to work together to ensure that low- and middle-income students have the opportunity to go to college. They are complemented by the third piece of our higher education strategy, the reauthorization of the Higher Education Act (HEA). Because these three pieces are part of a coordinated effort, I now would like to touch briefly on our strategy for reauthorizing the HEA.

The HEA, which authorizes our postsecondary education programs, is scheduled for reauthorization. We believe that the current HEA provides a strong foundation of support for higher education. Its programs work well and have opened the doors to college for millions of students over the last several decades. That is why we support these programs so strongly in our fiscal year 1998 budget. Our task now is to consider how to make the HEA better and to ensure that it can address the challenges of the twenty-first century.

In developing our postsecondary education strategy, we are consulting the people most affected by our programs. In December, we held a series of public meetings in six cities across the country so that we could listen to and learn from all parts of the higher education community. We have been very encouraged by the high level of support we have heard both for our tax proposals and for the programs of the HEA.

While we are in the process of developing our ideas and do not have complete reauthorization proposals yet, we do know that whatever decisions we make will be designed to benefit students. We also know that our overall proposal will be aggressive, but realistic. We will identify priorities and suggest targeted program reforms

rather than a "wish list" of new programs that we cannot fund in the context of a balanced budget.

Let me share with you now the four principles, reinforced by our tax and budget proposals, that guide the development of our reauthorization proposal.

The first principle is access—opportunity with responsibility. We must continue our efforts to ensure that all students, including disabled and economically disadvantaged students, have access to higher education. At the same time, we must help families and students take responsibility for their own education. Postsecondary institutions, too, have the responsibility to protect the value of their students' access by providing high-quality programs, supporting students, restraining tuition increases, and being fiscally responsible in their management of federal funds. And States must take responsibility for investing in the education of their students in spite of tight state budgets and limited resources. We are considering several changes to the HEA that will enhance access.

For example, we will do our best to guarantee that the HEA provides a strong Pell Grant program for years to come. We will complement our increased funding for the program this year by authorizing future maximum awards that are ambitious but also paid for within our balanced budget proposal. Likewise, strong student loan programs are necessary to ensure access. Our proposal will continue our commitment to both the FFEL and Direct Loan programs. We can best serve students by maintaining a healthy and fair competition between the two programs while promoting efficiencies in the guaranty agency and lender systems.

Our second reauthorization principle is the support of effective education, high standards, and high achievement. Federal programs should continue to promote and enhance outstanding educational opportunities and encourage students to take advantage of those opportunities to the best of their abilities. We should also encourage the effective use of new technologies to meet the changing needs of students by providing access to high quality postsecondary education.

For example, in promoting effective education and high standards, we will propose changes to Title V of the HEA that focus on recruiting the next generation of teachers, preparing them well, and supporting them in their first few critical years. Teaching is a key variable in students' learning; without effective teaching, the highest standards in the world will not ensure that our children are well educated. We must give teachers the education and support that they need to teach to higher standards.

The reauthorized HEA should simplify program delivery and improve management, and that is our third guiding principle for reauthorization. Students and postsecondary institutions should continue to receive outstanding customer service in a predictable and seamless way so that they are assured of aid and can plan ahead. Federal programs should be simplified and burden reduced as much as possible.

We have already begun efforts to simplify program delivery through initiatives such as Easy Access for Students and Institutions (EASI). Students deserve a friendly system when they seek information about financial aid and apply for it. We are examining ways that the HEA could encourage a streamlined delivery system for student financial aid.

And our fourth principle is that we must improve outreach to potential students and ensure strong links among elementary and secondary education, postsecondary education, and employment. As the President emphasized in his "Call to Action," this principle is key to our goal of making college more accessible and more affordable for Americans. Too many young people lose their way between high school and the world of work. We must reach out to potential students as part of our effort to change the way that young people and their families participate in postsecondary education—so that everyone places a high priority on continuing his or her education. With this in mind, we will strengthen the TRIO programs, which provide students with needed information and support so that they will be ready to go to college.

CONCLUSION

As this testimony indicates, our vision for higher education includes tax incentives to help families pay for college, as well as major increases in funding for important postsecondary education programs and a Higher Education Act that is even stronger than it is today. This Administration is calling for a significant increase in our national commitment to postsecondary education, and I hope you will give strong consideration to our proposals.

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Statement of American Association of University Professors

The American Association of University Professors (AAUP) welcomes the emphasis on education in the President's proposed budget for FY 1998. As faculty members in this nation's colleges and universities, our 45,500 members are key partners with government and others in the higher education community in a commitment to the future of higher education.

The AAUP pays close attention to the development of congressional and federal policies because we recognize that education is not just a private and individual matter. The nation as a whole relies on an educated populace to solve its problems, to contribute to a vigorous and growing economy, to stretch the horizons of ideas and expression, and to recreate democracy in each generation.

ISSUES OF ACCESS.

This nation has made important investments in higher education—helping students who attend both public and private institutions. As a result, we have one of the finest higher education systems in the world. Providing access to education is a particular challenge in times of rising costs and increasing demand. The AAUP believes that college and university enrollment should be a reachable, affordable, and realistic part of the lives of all those who have the ability and determination to pursue higher education, and we support the President's proposals to this end.

ISSUES OF QUALITY.

Students who have been educated in American colleges and universities should be well prepared to encounter the world's complexities and to contribute something of worth in their chosen fields. The new technologies that touch every aspect of higher education are both costly and necessary tools for the enterprise.

Quality postsecondary education not only conveys information, but also inspires curiosity, encourages critical thinking, and elicits the most important questions—the ones that, as of yet, have no answers. As our profession and our institutions try new ways of communicating and new ways of teaching and learning, we seek to preserve the essentials of higher education. We seek a future in education that protects openings for the unprogrammed question, the unanticipated insight, the unpredictable experiment, and the depth and complexity of real learning. The AAUP supports high quality education for all students, and we support the President's proposals to this end.

FEDERAL GOVERNMENT SUPPORT.

For decades, federal programs have supported quality education at the university and college level, and have made education accessible to millions of students. Nearly half of all students now attending college receive assistance from some type of federal programs. For many of them, federal assistance opened a previously closed door to higher education.

We appreciate the attention that this committee is devoting to education-related issues. We believe that the Ways and Means Committee will make an important contribution as Congress explores ways to help middle-income families finance higher education for their children, and to open the doors of college to young people whose families might never have considered higher education as an option for their children's future.

TAX-RELATED EDUCATION INITIATIVES.

The AAUP acknowledges that the tax code can be an efficient tool for distributing benefits directed toward particular social purposes. Higher education serves a core national purpose—the strengthening of our economic and democratic base through the support of an educated citizenry. So it seems appropriate that tax benefits direct resources toward this purpose.

THE HOPE SCHOLARSHIP TAX CREDIT.

The AAUP supports the basic concept of the President's HOPE Scholarship Tax Credit proposal, as a useful part of a complete higher education package that includes increases in the Pell Grant, work study, and TRIO programs, along with improvements in student loan programs and direct institutional aid. We have stressed

to the Administration the importance of balance among these programs, so that, together, they would afford access to high quality higher education for all Americans regardless of income or wealth.

We would like to work closely with Congress in the shaping of the details of the HOPE Scholarship Tax Credit. Specifically, we urge Congress to make the following modifications in the President's proposal:

• The HOPE Scholarship tax credit should be refundable. Unless the credit is refundable, it is useless to low-income families and to many independent students, who typically eke out a subsistence living during their college years. Those low income students and families who are fortunate enough to qualify for a Pell Grant might benefit more from the grant than they would from the tax credit. But there are two important differences:

(1) Not everyone who qualifies for a Pell Grant receives the maximum level. Indeed, a low income working student is very likely to fall between the lines of eligibility for a Pell Grant and the ability to make use of a non-refundable tax credit. A single independent student scraping by on $10,000 of earnings annually from part-time work would benefit less from the credit than a student earning significantly more. But because of the student's earnings, the Pell Grant is unlikely to fill in the gap. We urge the committee to look carefully at the impact on students who qualify for very small Pell Grants, or whose earned incomes place them just above the eligibility line for Pell Grants.

(2) The HOPE Scholarship Tax Credit operates like an entitlement, while the Pell Grant depends on annual appropriations from the discretionary budget. The full Tax Credit will be available to families earning up to $80,000, whereas the full authorized level for the Pell Grant program is not available to anyone. The proportion of the maximum grant that the most needy students actually receive is adjusted year to year, depending on the amount of money appropriated for the program.

• The HOPE Scholarship tax credit should not be considered an "asset" to be subtracted from the Pell Grant award, for students who qualify for both. Even with recent generous increases, the maximum Pell Grant award has not kept pace with inflation To meet 78% of a student's expenses (as it did in the late '70s), the Pell Grant would have to offer a maximum grant of $4000 to $5000, instead of the $3000 offered in the President's FY98 budget proposal. By adding the HOPE Scholarship to the maximum Pell Grant, the "grant package" would just equal the authorized (but never appropriated) maximum grant for the Pell grant program ($4500).

• We urge Congress to make the HOPE Scholarship tax credit available (proportionately) to less-than-half-time students who otherwise qualify for the credit. By offering the credit only to students attending college at least half time, the President's proposal withholds assistance from community college students who might be trying to hold a life together with a part-time or full-time job, while taking a class or two to improve their chances for future employment. Given the number of heads of families who will be required in the next few years to leave welfare and take a job—any job—the need for community college level educational opportunities will be great. These young families, supporting small children with (probably) just one adult's income, need greater flexibility. We urge the committee to consider inserting more flexibility into the HOPE program.

• And finally, we urge Congress to eliminate the requirement that a student maintain a "B" average in his or her first year, in order to qualify for a HOPE Scholarship for the second year. The AAUP supports an emphasis on encouraging students' best performance. However, we caution against well-intentioned expectations that may result in overly burdensome requirements on the institutions and on new students. We believe that the "merit" aspects of the HOPE Scholarship program will be difficult to implement fairly and efficiently. Professors already experience substantial pressures to enhance the grades of students who "need" better grades for sports, scholarship, or other reasons. The HOPE Scholarship would add to the unwieldy burden.

In addition, the HOPE scholarship is designed to open college doors (for the first year) to all students. It seems ironic and perhaps cruel to require not just that the student succeed in the college environment, but that the student excel. If the HOPE Scholarship is offering a first chance to a student who has had little financial or educational support from home, that student succeeds—and the program succeeds—when the student "makes satisfactory progress" on his or her courses in that first exploratory year. We urge Congress to align the "merit" requirements of the HOPE Scholarship program with the "merit" requirements of other financial aid programs.

OTHER EDUCATION TAX BENEFIT PROPOSALS.

AAUP welcomes the additional proposals in the President's budget that will assist middle-income families in providing higher education for their children. We recognize that an education expense tax deduction, and the proposed penalty-free withdrawals from Individual Retirement Accounts will be most useful to relatively higher income families. Yet for many of these families, these provisions will enable them to finance education through savings rather than through debt.

We urge Congress to pay close attention to principles of tax equity in considering these proposals. In some details, the tax deduction, as proposed, may offer greater benefits to higher income families than to middle income families who, presumably, need assistance more. For a family in the 15% tax bracket, the $10,000 per year tax deduction would be equivalent in value to the $1500 tax credit. For families in the 28% bracket (beginning at $75,000 taxable income) the tax deduction would be worth $2800, almost twice the value of the tax credit, and nearly as much as the very lowest income student might receive through a maximum Pell Grant. As a matter of equity, the AAUP recommends that the tax deduction be designed to offer no more benefit to high income families than to middle income families.

We support the President's education-related tax proposals, with the recommended modifications, as a part of a complete package of education assistance designed to enhance the quality of higher education as well as access to higher education regardless of wealth or income. The generalized distribution of education dollars through the tax code is useful as an additional device to help families and students pay education costs.

But we urge Congress to continue providing full support for the higher education programs funded through the discretionary portion of the budget. Many of them are carefully targeted to meet certain challenges—distributing resources to colleges that enroll disadvantaged students, supporting low and middle-income students with grants and subsidized loans, and offering assistance to graduate students and institutions taking on special projects.

The purpose of the HOPE scholarship program and the other tax-related education programs would be defeated if their adoption meant that higher education institutions would lose other government support, causing a compromise in quality, or that student aid would be less available to low-income students, causing a restriction in access to higher education. Supporting higher education is a tall order, and one with many aspects. We appreciate the support of this committee.

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Statement of Willie C. Brown, Jr., President, American Student Association of Community Colleges

Mr. Chairman, it was my pleasure to testify before you in the last Congress on behalf of the higher education community, in support of employee educational assistance. At that time I was ASACC Vice President for the Southeast Region. I am now ASACC President, and I am asked by ASACC to speak for community college students on several priorities.

As younger Americans who must bear the brunt of carrying the national debt and the interest on it for at least the next generation, if not longer, we understand all too clearly the magnitude of this challenge. We also know that it can be met only if we work hard, at good jobs. We must have workplace skills at the cutting edge of global competition. And, we must have lifelong access, as President Clinton has repeatedly observed, to the education, training, and retraining that develop those skills. Only high skills with high wages will get us through! We have no other choice. In this spirit, we want to concentrate our testimony on two priorities.

I. EMPLOYEE EDUCATIONAL ASSISTANCE

First, we reaffirm our wholehearted support for permanent reenactment of tax code Section 127, to cover both undergraduate and graduate courses. Employee educational assistance (EEA), alongside Pell Grants, represents in our view the best competitiveness strategy Congress has yet devised. We do not say this idly, because we see these federal landmarks at work in students' lives every day.

EEA is federalism at its best. It leverages private investment and promotes individual initiative, with very real dividends for both the economy and society, with a minimum of governmental regulation and paperwork. It also resonates with capitalism. More and more business leaders, as well as economists, are recognizing that

the long-term success of most ventures is chiefly dependent on the quality of the human capital.

It seems obvious to us that EEA deserves a large share of credit for the exceptional performance and productivity of the American workforce in the 1980s and 90s, in the face of intense labor cost pressures from the Pacific Rim and Latin America, and in spite of glaring deficiencies in our school systems as gauged by the global rank of our students in math and science. This simply underscores the importance of access to lifelong learning, at which the U.S. easily ranks first. EEA is the touchstone of that access. Thanks to EEA and Pell Grants, the American Dream is still open to nearly all who are willing to assert themselves. Of course, we should not overlook the contributions that vocational rehabilitation, special education, and vocational education also make to such access.

Some may wonder why our community college student network supports EEA for graduate students. Again the answer is lifelong learning. It will be women and older workers who will be hurt most if workers with bachelor or higher degrees are denied EEA. Career-wise, college degrees have far less staying power than they once had. Because women so frequently interrupt their careers to fulfill family agendas, they have become the majority of workers using EEA. Mothers should not be penalized because their bachelor's degree lost job value while they were raising children.

Critics who believe EEA is widely abused by high-paid employees pursuing professional degrees are not supported by the facts. As the Department of Education demonstrated in the 1993 NPSAS study, EEA reimbursements averaged only about one-fourth the annual limit of $5,250. Such an average suggests that the reimbursement in most cases covered a single course within the tax year—hardly a fast track to any professional degree. NPSAS also showed that reimbursements ran higher averages among workers of the 24–33 age groups—those most often struggling to solidify their careers, one course at a time.

The employer's self interest is a reliable safeguard against abuse. Only the courses that bear directly on the employee's productivity are likely to be approved by profit-minded bosses. Courses that merely feed personal ambition are much less likely to be funded, at least in the private sector.

Career longevity may well be the most compelling argument of all for Section 127. It was shown years ago that workers with a college degree, either two-year or four-year, typically stayed four to five years longer on the job, or in self-employment, than workers with only a high school education. Without even factoring in the higher earning power of the college education over the high school education, when tax revenue is computed from the extra years in the workforce, the relatively modest federal investment in EEA is repaid a hundred-fold, or more. More—because the added years in the workforce cut significantly the prospective federal burden of such social costs as welfare, unemployment insurance, Social Security and Medicaid.

II. TUITION TAX CREDITS

Middle-income families and students are losing ground steadily in the struggle to meet college costs, and the best remedy is tax relief. We strongly support the proposed $1,500 federal tax credit, the so called Hope Scholarships, for the first two years of college.

ASACC takes this stand with two qualifications: Safegaurds must be enacted both to keep the IRS from more heavily policing the lives of students, families and institutions involved in the tax credit process, and to ensure that the value of the tax credits is not nullified by more escalation of college costs beyond the general rate of inflation. The original intent of Pell Grants and student loans, i.e., to universalize access to postsecondary learning, has been largely eroded by the steady escalation of college costs in excess of the general rate of inflation. The higher education community has a responsibility to the national interest to do more to rein in costs to students, and to make their programs still more accessible and convenient to their job-holding clientele, which is now the dominant population in higher education. As a national average, 80 percent of the students in community colleges hold full-time or part-time jobs, and a growing number are taxpayers with college degrees who are pursuing new job skills. This underscores again the significance of employee educational assistance.

Because there is a growing gap between the college participation of students from high-income homes and those lower on the income scale, the tax credit should be targeted toward students and families at the middle and lower incomes. For this reason, the credit should not be offset by Pell Grants, SEOG, or state assistance, but should be limited only by total cost of attendance. For community college students, the cost of books for a term often exceeds the cost of tuition and fees. This is another issue that deserves close scrutiny by the Congress. The credit should be

available to students doing three credit hours or more per term at an accredited institution, who meets institutional standards of academic progress. Restricting eligibility to those with a B grade-point average poses an administrative nightmare for institutions and government alike. Federal regulation and paperwork must be held to the absolute minimum if the program is to succeed.

Our appreciation, Mr. Chairman, for making our views part of the Committee record on tax reform. Our thanks also to Frank Mensel, ASACC National Policy Advisor, for his assistance in the preparation of this testimony.

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Statement of Computing Technology Industry Association

The Computing Technology Industry Association (CompTIA) congratulates the House Ways and Means Committee for holding hearings on incentives to encourage education and training. CompTIA believes that productive investment in education and training are critical to maintaining US economic strength. While it is also important to encourage investment in research and development and investment in other productive assets, our nation's most important asset is our people. Your hearings will help focus national attention on a variety of proposals, all of them constructive, intended to encourage investment in education and training both directly and indirectly. Both thoughtful Republican members and Democratic members deserve the thanks of business and voters for their thoughtful focus on the issue.

The Administration deserves much credit for drawing public attention to this important priority. President Clinton's proposed $1,500 student tuition training tax credit would facilitate the training of technicians in the computing technology sector. It could strengthen training programs available through public and private schools, colleges, universities, companies and associations. The proposed $10,000 college tuition deductions would also help train needed engineers and other skilled professionals for our industry.

CompTIA suggests that continuously updated objective rating criteria be applied to the many constructive proposals that have been offered and to additional proposals that will be suggested. That criteria should be return on the taxpayer's investment in education and training. As important as education and training incentives and tax credits may be, we do not believe that they should be exempted from from the same scrutiny that both federal spending and other tax incentives face in an era of budget austerity.

During the legislative process the many proposed education and training incentives will face budgetary challenges. If revenue losses must be reduced because of budget priorities, we urge the committee to restrict the education incentives and training tax credit eligibility to job categories where the wages are highest and the supply of workers the lowest. Eligibility should be limited to training for those skills for only so long as the shortage exists but should not be arbitrarily limited by who pays or the provider.

There is a growing shortage of workers at the doctoral level and as well as at the technician level in the computing technology industry. Compensation is excellent at all levels. The objective should be to provide the appropriate type of education or training required to relieve the shortage. As an example the Computing Technology Industry Association sponsors the A+ voluntary computer technician certification program, which has become the U.S. core skills standard and is rapidly becoming the international standard. Standards are set and continuously upgraded by a committee of industry training leaders, other trade associations, training companies, service providers, industry consultants, and academia. Many major computer manufacturers require that all technicians providing their warranty work possess this certification. The cost of training which prepares workers to pass this rigid certification examination should be eligible for training credits. Individuals and businesses should both be eligible for credits and deductions.

Organizations demonstrating that they have in place the type of training to teach these needed skills should be recognized as eligible for the credit whether they be a university, community college, private school, trade association, or a company. This would result in the expeditious reduction of the worker shortages and recovery of the investment in education and training through increased personal and corporate income taxes generated as a result of the programs. Once this or any other skill shortage has been eliminated, the additional educational tax incentives for that skill should be terminated. As new shortages develop they would become eligible for the educational incentives and training credits once they reach the trigger level.

Some educational investments meet the return on investment criteria by their very nature. For example when an employer invests in an employees education or

training it is almost certainly done because there is a demand for the newly acquired skills which result. For that reason we believe that the extension of section 127, the employee educational assistance exclusion, should be a part of any education and training package. A balance of educational investment incentives and capital investment incentives such as the R&D tax credit coupled with fiscal spending restraint, will form three legs of a balanced platform need to propel the US economy into the next millennium.

Founded in 1984, the Computing Technology Industry Association represents over 6,300 microcomputer resellers, distributors, manufacturers, software publishers and service companies. CompTIA is a growing vertically integrated computing sector trade association focused on training and education, technical standards, and on promoting public policy that will contribute to US technological leadership.

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Statement of Section 127 Coalition

The Section 127 Coalition is a diverse group of business, labor, and education organizations that are committed to making the exclusion for employer-provided educational assistance found in section 127 a permanent part of the tax code. The Coalition appreciates the opportunity to submit this written statement as the House Committee on Ways and Means considers the education and training provisions contained in the Administration's Fiscal Year 1998 budget proposal to Congress.

Section 127 allows workers to exclude up to $5,250 a year in reimbursements or direct payments for tuition, fees, and books for certain courses. Section 127 was last extended, retroactively, for the period January 1, 1995 to July 1, 1997 in the Small Business Job Protection Act of 1996 (P.L. 104–188). After July 1, 1996, however, graduate courses can no longer be excluded from taxable income under section 127. H.R. 127 has been introduced in the 105th Congress by Representatives Clay Shaw (R–FL), and Sander Levin (D–MI) and enjoys broad bipartisan support. This legislation would make section 127 a permanent part of the tax code and reinstate section 127 retroactively back to July 1, 1996 for graduate courses. President Clinton's Fiscal Year 1998 budget proposal to Congress also contains an extension of section 127 through December 31, 2000 for both undergraduate and graduate courses.

Congressional action making section 127 a permanent part of the tax code would remove the uncertainty and ambiguity that employees and employers now regularly face, and would be consistent with the intent of Congress when the provision was first enacted in 1978. At that time, supporters of employer-provided educational assistance hoped that the enactment of the provision would meet three broad goals: (1) reduce the complexity of the tax code; (2) reduce possible inequities among taxpayers; and (3) remove disincentives to upward mobility. Several studies have been conducted on section 127 reviewing the application, use, and effectiveness of the benefits. The two most recent studies on employer-provided educational assistance include a 1995 study conducted by the National Association of Independent Colleges and Universities (NAICU), entitled "Who Benefits from Section 127," and a Government Accounting Office (GAO) study completed in December of 1996 entitled, "Tax Expenditures: Information on Employer-Provided Educational Assistance" (GAO/GGD–97–28). Review of the information contained in these studies clearly demonstrates that the provision is meeting the original intent of Congress.

Reduce the Complexity of the Tax Code—Prior to 1978, only educational assistance provided by an employer to an employee that related to the individual's job was excluded from an employee's gross taxable income (sections 62 and 132 of the Internal Revenue Code). The "job-related" test contained in Treasury Regulation 1.162–5 was confusing to both employers and employees and resulted in both the Internal Revenue Service and the courts making arbitrary decisions as to what type of employer-provided educational assistance successfully met the test of job-relatedness. Unlike other code sections that govern educational assistance, section 127 does not require either an employer or employee to make a distinction between job-related and non-job related educational assistance in order for the employee to receive the assistance. Section 127 therefore ensures that administrative complexity is reduced and clarity is achieved for both the employer and employee. If Congress fails to reinstate section 127, employers and employees again will be faced with the difficult task of determining whether educational assistance meets the "job-relatedness" test. As a result, the balance and equity among taxpayers that has been established through section 127 would be eliminated and the opportunities for less-educated and skilled employees to improve their skills with additional training would be restricted significantly.

Reduce Possible Inequities Among Taxpayers—This goal was especially important to Congressional sponsors of section 127. Under the job-related test of sections 62 and 132, most entry-level employees are unable to claim an exclusion for an educational expense because their job descriptions and responsibilities are not broad enough to meet the test. In effect, only highly skilled individuals are able to use job-related educational assistance. The goal of section 127 is to allow employees in lower-skilled positions the opportunity to receive educational assistance from their employer and for these individuals to utilize the benefit without the worry of the job-related test. According to the NAICU study, 43.6% of section 127 beneficiaries were in clerical or secretarial positions.

Like any other benefit, employers are not required to provide section 127 benefits to their employees. If an employer chooses to provide educational assistance benefits to its employees, the employer must offer the benefits to all employees on a nondiscriminatory basis that does not favor the highly compensated. This requirement, together with information from various studies, indicates that lower-skilled individuals are utilizing the benefit at a greater rate than those in more skill-intensive professions.

Remove Disincentives to Upward Mobility—While section 127 provides the opportunity for individuals to advance, it does not guarantee it. Recipients of section 127 are not traditional students: they are working, most of them in a full-time capacity. They choose to return to school on a part-time basis to improve their skills and educational qualifications. Without their employer's assistance, many of these individuals would not be able to pay for the education themselves. Each time the provision expires and employers begin to withhold taxes on the benefit, individuals relying on section 127 discontinue or scale back their undergraduate and graduate educational pursuits because they cannot afford to even pay the taxes on the benefit. According to the NAICU study, 33 percent of section 127 recipients were pursuing associate degrees, 23 percent were in bachelor's degree programs, and 13 percent were enrolled in programs that awarded undergraduate educational certificates. According to this same study, nearly 85 percent of section 127 recipients earned less than $50,000 and 50 percent of the recipients earned less than $32,000. Clearly those who section 127 was intended to benefit are using this opportunity to upgrade their skills, keep current in this rapidly changing technological environment, and potentially advance within their organization.

As Congress debates the role of the federal government in education, there are some important points to consider when contemplating a permanent extension of section 127:

Section 127 is Not a Government Program—This is a purely private sector initiative and the most significant provision encouraging employer investment in their worker's continuing education. There is no large bureaucracy to administer the program. Like any other benefit, employers are not required to provide section 127 benefits to their employees. Nevertheless, employers provide these benefits to their employees because they see value and a return on the investment in their employees' education. Employees use section 127 benefits to keep current with changing trends in rapidly advancing fields as well as to improve basic skills.

Section 127 Encourages Business Support and Partnership of Education Initiatives—This provision is a good proposal for employers and employees alike, encouraging partnerships between a company and its individual employees. Companies see section 127 benefits as a prudent and an economically sound investment in its workforce because they receive, in return, a better educated and more technically skilled worker. Employees view section 127 as a way to improve their work skills and advance up the ladder of success. These benefits also provide companies with additional flexibility when conducting a reengineering or downsizing effort since educational assistance may be offered through an outreach program to their laid-off workers or be used to retrain employees for other positions.

Moreover, a recent survey of economists suggests that additional funding for education as well as research and development are the most significant policies needed to boost the wages of lower-paid workers and increase the long-term economic growth rate.

The Coalition applauds the bipartisan efforts to make section 127 permanent. The Small Business Job Protection Act reinstated section 127 once again—the eighth time that the provision has been extended since it was first enacted as part of the Revenue Act of 1978. Every extension of section 127 has been retroactive. The on-again, off-again extension of section 127 causes uncertainty in the tax code, creates administrative difficulties for employers, corrodes our system of voluntary compliance with the tax laws, and leaves employees with unanticipated tax liabilities.

The continued education and development of the U.S. worker are fundamental to meeting the challenges of the international marketplace. The Coalition urges Con-

gress to make a commitment to the continuing education of our work force by reinstating the exclusion for graduate courses and making section 127 permanent.

Thank you for this opportunity to express our support for the permanent extension of section 127.

This statement has been endorsed by the following organizations:

American Association of Community Colleges
American Association of Engineering Societies
American Association of University Professors
American Council on Education
American Federation of State, County and Municipal Employees
American Federation of Teachers
American Society of Civil Engineers
American Society for Engineering Education
American Society for Payroll Management
American Society for Training and Development
American Society of Mechanical Engineers
American Student Association of Community Colleges
AMP Incorporated
Associated General Contractors of America
Association of Community College Trustees
California Institute of Technology
Caterpillar, Incorporated
Ceridian Corporation
College and University Personnel Association
Council for Adult and Experiential Learning
Council of Graduate Schools
Institute of Electrical and Electronics Engineers-United States Activities
International Personnel Management Association
Johns Hopkins University
Land O' Lakes Corporation
Marymount University
National Alliance of Business
National Association of College and University Business Officers
National Association of Graduate-Professional Students
National Association of Independent Colleges and Universities
National Tooling and Machining Association
New York University
NYNEX
Raytheon Company
Society for Human Resource Development
Telephone and Data Systems, Inc.
The Women's College, University of Denver
United Technologies Corporation
University Continuing Education Association
University of Miami
University of Michigan
U.S. Chamber of Commerce

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