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To the

COMMITTEE ON EDUCATION AND LABOR

U.S. HOUSE OF REPRESENTATIVES

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Chairman Miller and members of the committee. I appreciate the opportunity to be here. I have testified on several occasions before this committee and appreciate the opportunity to appear again today.

I have three points I wish to make. In addition to this statement, my views are more elaborately outlined in the attached study on federal student financial assistance prepared by my colleague at the Center for College Affordability and Productivity, Andrew Gillen.

First, the law of unintended consequences has led to higher education outcomes far different than intended as federal student assistance has expanded over the past 35 years. For example, I think it is hard to demonstrate that enhanced federal assistance has either significantly expanded college participation or brought about much greater access to higher education by those who are financially disadvantaged. In their totality, federal programs have contributed to the "tuition bubble" that has been an unfortunate feature of American higher education. The proposed additional expansions contemplated will likely not have the intended effects on student participation, access and equality of educational opportunity.

Second, the proposal to end the Federal Family Education Loan (FFEL) program and replace it with direct federal student lending will have negative consequences on students quite independent of the alleged financial consequences to the federal government. People like to have choices, and private loan providers do not follow the one-size-fits-all model implicit in the federal direct loan program. I understand that there is some dispute on the potential savings arising from a budgetary perspective to going to direct loans, and I suspect the true savings are in fact exaggerated, but even if that is not the case, the move away from diversity in provider offerings is a step backward.

Third, the proposal to sharply expand the Pell Grant program by making it an entitlement offered to far more students than presently, with larger sized grants, is fiscally irresponsible. It may even be a potential factor in raising college costs, statutory provisions to control costs notwithstanding.

Turning to the first point, in their latest book Harvard professors Claudia Goldin and Lawrence Katz argue that the rate of increase in educational attainment in the United States slowed significantly beginning in the mid 1970s.[1] Speaking of the twentieth century, Goldin and Katz assert that "during the first three quarters of the century educational attainment rose rapidly, but during the last quarter of the century, it stagnated."[2] It is not entirely a coincidence, I think, that the major federal grant program, Pell Grants, and, even more importantly, federal student loans, began around 1975.

From the mid 1950s to the mid 1970s, higher education enrollments almost quadrupled, before Pell Grants existed and before federal student loans were large and universally available. Tuition tax credits were decades away during this era of huge enrollment growth. The era of exploding federal financial assistance has paralleled a significant slowdown in enrollment growth. From 1955 to 1975, enrollments grew at a compounded annual rate approaching 7.5 percent a year.[3] From 1975 to 2007, enrollments rose under 1.6 percent a year, not dramatically more than population growth. In the one-third of a century since 1975, when Pell Grants were just getting underway, enrollment growth has far less than doubled, at a time that the American population has grown well over 40 percent. America has fallen behind a double digit number of nations in the proportion of young adults with bachelor's degrees. The notion that federal financial aid has promoted college access in the United States is more a myth than a factual reality. Large expansion of these programs will almost certainly not promote higher access; this is particularly true of the student loan programs which are quantitatively larger in importance than Pell Grants, which have some possibility to have positive access attributes.

Now I am aware that other things are occurring in this era as well. Changes in income, the cost of college, the college-high school earnings differential, and changing state appropriations for colleges are a few variables that are relevant. Many of them, however, changed in ways that should increase enrollment. The point I am trying to make here is not that rising federal aid reduced the growth in participation itself, but rather that it is not correct to say that federal loan and grant programs have dramatically improved educational attainment in

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[1] Claudia Goldin and Lawrence Katz, *The Race Between Education and Technology* (Cambridge, MA: Harvard University Press, 2008).

[2] Goldin and Katz, p. 22.

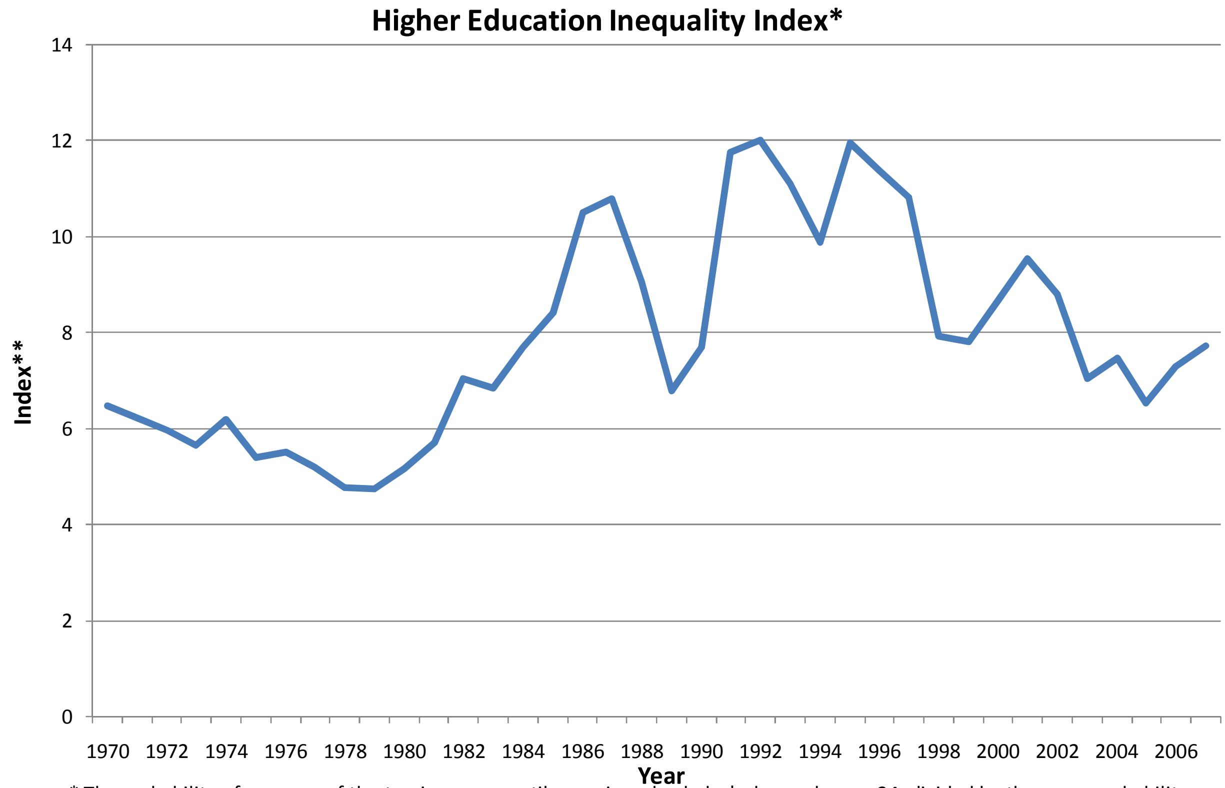
[3] This and subsequent statistics, unless otherwise indicated, are derived from various issues of the National Center for Education Statistics, *Digest of Education Statistics.*

the U.S. – if anything, the evidence suggests the impact of the programs likely has been to lower, not raise participation.

Why might that be? Most importantly, student aid potentially has increased the demand for higher education far more than it has increased supply, raising the price of colleges to students. If the price increases are substantial –as indeed they have been –it is possible that the enrollment reducing effects of higher federal student financial aid has more than offset the enrollment enhancement effects arising from lowering net effective prices to the student arising from student aid. If sticker prices have risen more than tuition discounting, counting federal aid as a form of that discounting, it is easy to arrive at a solution where the total college participation effect of student aid is negative.[4] To be sure, this is a simple generalization, and Pell Grants have probably had significantly different effects than student loans and tuition tax credits, but in aggregate the federal programs have almost certainly pushed the cost of higher education upwards.

Moreover, the era of greater federal aid is a period of declining equality of educational opportunity. When Chairman Miller completed his higher education, 1972, before a single Pell Grant had been awarded, persons from the top quartile of the income distribution had about six times as likely a probability of earning a bachelor's degree by age 24 as persons in the bottom quartile. Today, the upper income student has nearly eight times the probability of getting a degree. See the enclosed graph prepared by Matthew Denhart, showing the trends over time in this factor; although there has been modest improvement in recent years, inequality is greater today than it was when the Pell Grant program began in the mid-1970s.

[4] This discussion barely scratches the surface of this issue. For more, see Richard Vedder, *Going Broke By Degree: Why College Costs Too Much* (Washington, D.C.: AEI Press, 2004), or Andrew Gillen, *Financial Aid in Theory and Practice* (Washington, D.C.: Center for College Affordability and Productivity, April 2009).



* The probability of a person of the top income quartile earning a bachelor's degree by age 24, divided by the same probability for those in the bottom quartile of income

** Note: Index figures calculated based on a three-year moving average

Source: Postsecondary Education Opportunity, CCAP Calculations

Part of the explanation for this trend relates to non-aid related factors, such as the fact that some schools have deliberately restricted supply, especially for marginally achieving students, many of whom are low income, as part of an academic arms race where colleges try to gain prestige in published rankings that depend in part on the quality of students admitted and the proportion of students denied admission. But part no doubt relates to the fact that student loan programs have become very much a phenomenon utilized by comparatively affluent students who come from families with incomes exceeding the national median.

Department of Education data affirm this. For example, take Stafford loans. For dependent students from families of less than $20,000 income, 47.2 percent received Stafford loans in 2007-08, about the same percent (45.1 percent) as for students from families with over $80,000 income, a figure well above the median family income. Over 35 percent of students from families with over $100,000 income received such loans. [5]

[5] National Center for Education Statistics, *2007-08 National Postsecondary Student Aid Study (NPSAS:08)* (Washington, D.C.: U.S. Department of Education, April 2009), p. 9.

The President has spoken about his goal of dramatically expanding college participation. This is not the forum to discuss whether than goal is either practically reasonable or desirable. However, I can say that I very much doubt that the totality of the proposed legislative changes with respect to student aid will substantially further either the president's goal with respect to participation or with respect to equalizing educational opportunities among Americans.

Regarding the second point, it may be true that the direct student loan program will reduce the budgeted outlays of the federal government, but even the extent to which that is true I believe is open to debate. For example, with expanded lending occurring in a deep recession environment, can one predict with any accuracy student loan default rates? As the ratio of debts to starting postgraduate incomes rise, will not default on loans become a bigger issue? Indeed, are we perhaps setting some students up to fail, luring marginally qualified students to college, only to have them not succeed in graduating, but nonetheless incurring large debts?

But I want to emphasize a different point. Our government is one of the people, by the people, and for the people. And the people prefer choices to monopoly. We rejoice that technology has robbed the Post Office of much of its monopoly power, and reduced our reliance on unreliable delivery and long lines to buy stamps. Similarly, we find it far more pleasant to buy insurance for a new car from competitive insurance agents and companies than buying license plates for the car from the monopolistic Bureau of Motor Vehicles. Colleges have rightly mostly shunned the direct lending program because of the additional choices and services offered by private providers. To win business, the private providers have to please the customer, an incentive totally lacking if the government is the only major game in town. Are private providers earning monopoly profits from federal subsidies? Hardly, if recent exits from the industry and the stock prices of loan providers are valid indicators of profitability, as I think they are. I would note that in the past year, the price of Sallie Mae stock has plunged 71 percent, the Student Loan Corporation stock has fallen 62 percent, and that of Nelnet by 38 percent.[6] The loss in wealth to stockholders, including pension funds, in these companies, in addition to the potential unemployment of workers, is another reason you should give pause before endorsing the Obama Administration proposals, the testimony of Sallie Mae notwithstanding. Have some private providers engaged in dubious ethical or outright illegal practices in consort with universities? Probably, and they should be punished severely, perhaps by being forced to attend and write summaries of 100 congressional hearings, or some other form of near torture. But we should not deny students the opportunity to choose amongst multiple options because of a few ethically challenged individuals or institutions.

Moreover, any federal financing of student loans requires additional borrowing from a government that has engaged in extraordinarily reckless long term expansions in its own debt, an expansion that foists a large burden on future generations of Americans. The Congressional Budget Office tells us we will have nine trillion dollars in deficits over the next decade, which on

[6] As of May 18, 2009. Calculations are by Luke Myers of the Center for College Affordability and Productivity.

average is more than $100,000 debt for each family of four. To me, this is not only fiscally irresponsible, but downright immoral, since powerful persons, namely Congress and the Administration, are foisting burdens on young persons who adults should be protecting rather than harming –all in the name of short term political expediency. I am a patriotic American who loves our representative democracy, but with a heavy heart I must say, “shame on you.”

Moreover, the present value of the unfunded liabilities of federal entitlement programs now well exceeds 50 trillion dollars, or the entire value of the physical capital stock of this nation. Most of this is the Medicare and Social Security entitlement programs. It is the height of irresponsibility to add to that liability; rather, you should be working to whittle it down, for example, by reforming Social Security.

Let me also reiterate that the empirical evidence is unclear in my judgment whether the Pell Grant program is an effective means of promoting equal educational opportunity. My colleague Andrew Gillen has shown beautifully how Pell Grants can have positive enrollment effects without severe effects on tuition costs, but there is some empirical evidence to the contrary, and the historical evidence does not make one confident that Pell Grants have powerfully promoted equal economic opportunity given rising higher education inequality. Proposed revisions in the Perkins loan program are harder to interpret owing to a lack of detailed explanations, but both my colleague Dr. Gillen and I suspect that the proposals will serve to raise tuition costs.

Also, a significant expansion in federal aid programs, especially student loans, almost certainly will contribute to the tuition price explosion. When someone else is paying the bills, costs always rise, and all sorts of clever regulatory moves to stop this will simply either lead to denied student access, reductions in academic quality, and/or increased university bureaucracies, already obscenely large. In the past, the Pell Grant program has had relatively little tuition fee impact in my judgment, for reasons explained in the enclosed study by Dr. Gillen. But as Pell Grants increasingly become a middle class entitlement going to students who otherwise would go to college anyway, and grow in size, the probability that Pell expansion will be relatively tuition fee neutral becomes more problematic. Pell Grants are dwarfed in magnitude by student loan programs in any case. In total, the law of unintended consequences is at work, as the tuition bubble that federal policies such as student loans and tax credits have contributed to have undone any positive impacts that otherwise would occur.

Thank you for your attention.