STATEMENT OF

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before the

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Committee on Labor and Human Resources

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Mr. Chairman, I am pleased to be here today to discuss the Administration's, the Subcommittee's, and other proposals for reducing federal spending for student aid in fiscal years 1981 and 1982.

GROWTH OF STUDENT AID IN THE 1970s

The 1970s witnessed rapid growth in federal aid to students. In 1972, the Basic Educational Opportunity Grants program (now known as the Pell Grant program) was introduced to supplement other programs that ease low-income students' access to college. The Guaranteed Student Loan (GSL) program, established in 1966, addressed somewhat different goals, namely, helping to lighten the financial burden for less needy students, and supplementing the grant aid provided to the most needy students. But until recently, even the GSL program restricted eligibility for these highly subsidized loans to students from families with incomes below a specified level.

In the late 1970s, the federal focus began to shift. The Middle-Income Student Assistance Act of 1978 (MISAA) and the Higher Education Amendments of 1980 significantly broadened the scope of federal student assistance. MISAA extended eligibility for GSLs to all students enrolled at least half time, expanded eligibility for Pell Grants, and increased funding authorizations for most existing student aid programs. The 1980 amendments raised all grant programs' maximum benefit amounts, eliminated equity in the family home as a determinant of need, and created a loan program for parents.

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

Expanded eligibility without increased funding (in real terms) has reduced the federal commitment to assist the most needy students; at the same time, assistance to less needy students has increased. This dual effect has been particularly evident during the past year. While \$130 million was withdrawn from the needs-based Pell Grant program in fiscal year 1980, the untargeted GSL program--an entitlement program--required nearly \$650 million in supplemental funds, because both the demand for loans and interest rates were higher than anticipated. Likewise, while the continuing resolution for fiscal year 1980 increased funding for the GSL program by 56 percent (\$900 million), it cut the needs-based National Direct Student Loan (NDSL) program by 35 percent (\$100 million).

Without some change in the current programs, federal student assistance will almost certainly continue to shift away from helping the most needy students. If overall funding were to be limited but the programs not altered otherwise, funding for the needs-based programs would have to be cut, since the GSL program, as an entitlement, must always be fully funded.

THE CURRENT SITUATION

Before setting policy for 1982 and beyond, the Congress must resolve some funding issues for 1981. To maintain the level of services assumed in the continuing resolution and to pay for 1980 cost overruns, the Pell Grant program would need a supplemental appropriation of $1.5 billion above the $2.2 billion already appropriated for fiscal year 1981. If the full supplement were provided, 2.8 million students would have access to $3.2 billion in fiscal year 1981. More than 70 percent of this amount would go to students from families with incomes below $15,000.

Although the continuing resolution assured full funding for GSLs, the program will cost $2.6 billion in fiscal year 1981--an increase of nearly 65 percent from fiscal year 1980. Of this $2.6 billion, however, $2.0 billion will pay for obligations on loans made in prior years, and only $0.6 billion will be the result of new loans made in fiscal year 1981. The CBO estimates that 2.9 million students (25 percent more than last year) will borrow a total of $6.5 billion (35 percent more than last year).

OPTIONS FOR 1981

To gain control of rising costs for student aid, the Administration has proposed changes to both the Pell Grant and the GSL programs. In the Pell Grant program, the Administration proposes a combination of five changes for fiscal year 1981: keeping the maximum grant at the fiscal year 1980 level of $1,750; rescinding the previously approved inflation adjustment in the family living allowance; requiring a $750 self-help contribution from every student; rescinding the liberalized "cost-of-education" definitions included in the Higher Education Amendments of 1980; and eliminating the $10 per grant payment to institutions to cover administrative costs. The CBO estimates that these changes would reduce program costs by $0.7 billion, lowering the needed supplemental appropriation to $0.8 billion. All students but the neediest would receive less under this approach, and about 250,000 (or 9 percent) fewer would receive grants.

This Subcommittee is examining a different proposal for reducing 1981 Pell Grant costs. The Subcommittee's plan, as we understand it, would keep the maximum grant at $1,750 and rescind the liberalized cost-of-education definition; both of these features are also part of the Administration's plan. The Subcommittee's approach would not, however, rescind the inflation adjustment in the family living allowance, require a $750 self-help contribution, or eliminate institutions' administrative allowances. Instead, to achieve approximately the same level of spending reductions as the Administration proposes, the Subcommittee's plan would make four other changes: allow the Secretary of Education annually to establish the assessment rate used to determine how much a family should be expected to contribute from its discretionary income; count Social Security and Veterans' student benefits as student aid rather than as family income; rescind the provision of the 1980 amendments that excluded home equity from consideration in determining the expected family contribution; and rescind the 1980 provision that would have ended the distinction between families in which the student is the family head rather than a dependent.

If the Subcommittee's plan were adopted and the assessment rate on discretionary income retained, this proposal would have virtually the same effect as the Administration's proposal on program costs and participation in fiscal year 1981. Since program costs are highly sensitive to families' expected contributions, the costs and effects would be appreciably different if the Secretary were to change the assessment rate on discretionary income, however. Savings would also be much smaller if Social Security student benefits were eliminated, as proposed by the Administration and adopted by the Senate Finance Committee. Savings would decline in this case for two reasons: there would be fewer Social Security benefits to count as student aid, and more students would become eligible for Pell Grants.

The Congress could consider other options to achieve Pell Grant program savings. For example, the two-staged reduction procedure contained in the current law (or some variant) could be used. Or, as in the strategy adopted in fiscal year 1980, all awards could be cut by a given dollar amount.

To control GSL costs, the Administration proposes by this July to eliminate the in-school interest subsidy on student loans, to limit borrowing to assessed financial need, and to raise the interest rate on parent loans to offset all federal costs. Because more than 50 percent of annual loan volume occurs from July through September, implementing the changes by July 1 would realize half the future savings associated with a full year of program activity.

The precise reduction in loan volume would depend on the severity of the needs test. The CBO estimates have assumed that the combined effect of eliminating the in-school interest subsidy and limiting eligibility to assessed need would cut borrowing by about half. We also estimate that increasing interest on parent loans to market rates would reduce borrowing by about half.

The Administration's proposals could also affect the supply of private loan capital (from banks and thrift institutions). Requiring a needs assessment would add to the program's complexity and diminish lenders' yield per dollar lent, because although the average loan amount would go down, administrative costs for each loan would not. These changes would make the program less attractive to lenders and, as a result, some students--particularly the most needy, who are generally less preferred borrowers--could have difficulty obtaining loans.

This Subcommittee has been examining a proposal that, as we understand it, would restrict loans to students whose family incomes are below $25,000 or who have financial need, count Social Security and Veterans' student benefits as financial aid rather than as income, and increase from 9 to 14 percent the interest rate on loans to parents. In total, the CBO estimates that the Subcommittee's plan would reduce student loan volume by nearly 40 percent and would affect primarily students from families with incomes over the proposed cap, particularly those attending lower-cost institutions. If it were implemented by July 1, it would save $70 million of fiscal year 1981 budget authority, although there would be no outlays savings.

OPTIONS FOR 1982

For fiscal year 1982, the Administration would continue the Pell Grant program changes proposed for 1981. In addition, it would increase the assessment rate on discretionary income and, in determining the family contribution, would eliminate the deduction of state and local income taxes. We estimate these changes would maintain program costs at about $2.5 billion. Approximately 575,000 fewer students would receive grants than in the 1980-1981 academic year.

The Subcommittee's Pell Grant plan would continue the 1981 program changes for fiscal year 1982. As in 1981, it would have virtually the same effects on costs and on participation as the Administration's proposal.

With respect to GSLs, the Administration would continue in fiscal year 1982 the reductions proposed for initial implementation in late 1981. Assuming a July 1 effective date, fiscal year 1981 loan volume would be significantly reduced, yielding sizable budgetary savings in fiscal year 1982. Since borrowing in fiscal year 1982 would also be significantly reduced--by 50 percent for both students and parents--the CBO estimates total program savings of $0.8 billion in 1982.

In adopting the reconciliation bill, the Senate implicitly accepted the Administration's GSL proposal, but with an October rather than a July implementation date. As a result, the resolution assumes no GSL savings in fiscal year 1981, but a $0.6 billion savings in 1982.

In 1982, the Subcommittee's plan would continue the 1981 GSL program changes. If these changes were implemented by this July 1, fiscal year 1982 savings would be $0.5 billion because new loan volume would decline from $7.9 billion to $4.9 billion. Although total program costs would still grow to $2.9 billion, only $0.4 billion of this amount would be due to the new loans provided in fiscal year 1982. If these changes were not implemented until October 1, however, fiscal year 1982 savings would be significantly less--about $0.3 billion.

The Congress could reduce the growth in GSL program costs in various other ways. One option would be to limit special allowance payments to lenders. At present, private lenders receive a special federal allowance payment that assures them a yield equal to the 91-day Treasury bill rate plus 3.5 percentage points--18 5/8 percent on all outstanding loan capital in the last quarter. The actual amount of savings from reducing the special allowance payments would depend on the size of the reduction. Since special allowance payments for new loans represent only a small portion of total GSL cost savings would be modest at first, but they would eventually grow. A disadvantage of this approach is that any significant reduction in the special allowance that was not offset in some other way--say, by allowing lenders to charge higher interest rates--would make the GSL program unprofitable and could discourage lenders from participating.

Another option--a variant of one of the Administration's proposals--would eliminate the in-school interest subsidy but would automatically defer payment of accrued interest until students have left school. If the federal government were to pay the interest while students were in school--thus assuring lenders continuous payments from the time the loans were made--initial savings would be small. But as the accrued interest was repaid, savings would grow appreciably. Although this option would minimally increase the administrative complexity of the program, it should be possible to structure the changes in a way that still attracts lenders.

CONCLUSION

The choices available for achieving significant reductions in spending for student aid are quite limited, and the time constraints on enacting new legislation--especially any that is to become effective this July--are severe. The Subcommittee is therefore confined to a few difficult choices and a rigorous schedule. The CBO will try to assist you in any way we can during the course of your deliberations.