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Testimony of Tamara Draut, Director of the Economic Opportunity Program, Dēmos, and Author of *Strapped: Why America's 20- and 30-Somethings Can't Get Ahead*

Before the United States Senate Committee on Health, Education, Labor and Pensions

"Higher Education, Higher Cost and Higher Debt: Paying for College in the Future"
February 16, 2007

Chairman Kennedy and Ranking Member Enzi, thank you for the opportunity to testify today on issues of access and affordability in higher education. In my role as the director of the economic opportunity program at Dēmos, a nonprofit, nonpartisan research and public policy organization, I have studied and written critically about the decaying access and affordability crisis that now characterizes our higher education system.

As the primary lever for economic and social mobility, access to higher education is vital to this country's ability to make good on its promise of equal opportunity and upward mobility. The federal financial aid system is fundamental to fulfilling the promise of providing a college education to anyone who desires self-improvement and is committed to the work necessary for advanced study. As the primary source of financial aid for most students, the effectiveness of the federal panoply of grants and loans is paramount to ensuring college remains accessible and affordable to all students, regardless of their economic background.

Today, rising tuition and anemic federal financial aid has created what I call a "debt-for-diploma system." The debt-for-diploma system affects young adults' choices about college, including where they enroll and whether or not they complete their degree. The debt-for-diploma system also exerts powerful influence on young adults even after they leave college. With two out of three undergraduates leaving school with student loan debts averaging $19,300 ($17,500 for those attending 4-year public universities), the debt-for-diploma system continues to exert its

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influence in young adult's lives—impacting their financial stability long after they've accepted their diploma.

During my testimony, I will focus on the intertwined issues of access and affordability by discussing the following:

1) Trends in access, enrollment and completion in higher education by income and race/ethnicity;
2) Trends in state funding of higher education and its impact on tuition costs at 2- and 4-year colleges and universities;
3) Trends in student loan debt and federal financial aid, including the purchasing power of the Pell Grant and shifts in the composition of aid;
4) The larger economic context facing young adults; and
5) A proposal Demos has developed to strengthen the federal financial aid system so it again delivers on the promise of ensuring access regardless of family income.

Trends in Access Enrollment and Completion

Today, thousands of students are being denied access to postsecondary education simply because it is unaffordable. Thousands more enroll but drop out before obtaining a degree. In the 2001-02 school year, over 400,000 *college-qualified* high school graduates from low- and moderate-income families (those with incomes below $50,000) did not enroll in a four-year college, and 168,000 did not enroll in any college at all.[1] Unless immediate steps are taken to reverse this trend, over the decade 4.4 million qualified students will not attend a 4-year college and 2 million will not attend any college at all. The wide disparities in access to higher education run counter to our values of fairness, equal opportunity and upward mobility. In 1965, with the creation of the Higher Education Act, our nation set out to ensure that any student who wanted to pursue a college education should have the opportunity, regardless of family income. While we've never fully delivered on that promise, we are now losing ground.

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According to an analysis of data from the Department of Education, low- and middle-income households face high levels of unmeet need.[2] Unmet need equals the cost of attending college, including tuition and living expenses, minus expected family contribution and financial aid. According to the report, the average public college student from a family with an annual household income of $62,240 or less will have an average of $3,600 in annual unmet need. Public college students from families with an annual household income of $34,288 or less will experience an average annual unmet need of $4,689. Students who face unmet need compensate by working longer hours and/or by taking out private student loans. These calculations of unmet need only apply to those students who are enrolled, not the 168,000 who do not enroll at all due to financial barriers.

As a result of unmet need, the *highest* achieving students from poor backgrounds attend college at the same rate as the *lowest* achieving students from wealthy backgrounds.[3] Or to put it more coarsely: the least bright wealthy kids attend college at the same rate as the smartest poor kids.

- Gaps in enrollment between low-income families (below $25,000) and high-income families (above $75,000) are as wide as they were three decades ago.[4]

- Although roughly three-quarters of high school seniors continue their studies, only half receive a degree five years after studying, and only a quarter receive a bachelor's degree or higher. Students from low-income families complete degrees at a much lower rate than their wealthy counterparts: only 21 percent of low-income students who enroll in college will complete a bachelor's degree—compared to 62 percent of high-income students who enroll.[5]

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- The degree completion rate is much more disparate as a percentage of *all* students, not just those who enroll. Forty percent of students in the top quartile graduate with a 4-year degree, compared to only 6 percent of students in the lowest quartile.[6]

- One third of college entrants drop out before their second year. First generation college students are about twice as likely as students with college-educated parents to leave a four-year college before their second year.[7]

- The gap between college enrollment among whites, blacks and Hispanic students has widened over the last 30 years:

    - In 2000, the enrollment gap between white and black students was 11 percentage points, up from only 5 percentage points in 1972.[8]

    - The enrollment gap between white and Hispanic students was 13 percentage points in 2000, up from a 5 percentage point gap in 1972.

- Financial barriers prevent 48 percent of college-qualified high school graduates from low-income families from attending a four-year college; 22 percent will not attend any college at all. The percentages are similar for students in moderate-income families with household incomes less than $50,000.[9]

Academic preparation is also critical to ensuring that lower income students enroll and complete college degrees. But the growing disparity between enrollments and degree completion is occurring during a time when academic preparation for college has steadily risen among low-income students. More than half of high school seniors in households with incomes below $36,000 have completed college preparatory courses—up from just over one-third in 1987.

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Nonetheless, racial and class disparities continue to result in fewer low-income and students of color who are prepared for higher education.

The current access problem will be further strained as the largest generation since the Baby Boomers begins to age out of high school. The traditional college-age population is projected to grow by 16 percent between 2000 and 2015.[10] This generation will be more ethnically diverse, better prepared for college, and more likely to have financial need for college. By 2015, 80 percent of the college-age population will be non-white, and almost 50 percent will be Hispanic. Left unchecked, the disparities in educational opportunity could severely threaten our social cohesion, dividing the country into a well-educated, white minority and an under-educated non-white majority.

Impact on Economic Growth

Having fewer highly trained and educated workers dampens the economic productivity and growth of the nation. It's estimated that narrowing the gap in the college participation rate would add $250 billion in gross domestic product and $85 billion in tax revenue.[11]

Ensuring that all qualified students can pursue education beyond high school is critical for maintaining the vitality of the American labor force. Nearly 60 percent of jobs today require some college.[12] Over the next decade, six of the ten *fastest* growing occupations require an associate or bachelor's degree.[13] At the same time, job growth predictions also show that the *largest* growth in jobs over the next decade will be in the low-wage sector—those not requiring any post-secondary training.

Still other studies show that the looming retirement of the Baby Boomers will result in a major shortage of skilled workers.[14] The reason is simple: unlike the Boomers, who achieved higher levels of education than their parents and grandparents, successive generations have gotten about the same amount of education as their parents.[15] As the labor force is expected to grow far less in

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the next 20 years than it did in the last two decades, there may be a shortage of workers with at least some college education.[16]

The current growth in outsourcing of service sector jobs may threaten the potential for young, educated workers to find jobs to match their skill set. At this time, however, the scope of the effects on economic growth and job creation caused by outsourcing is unclear and widely debated.

Whether or not the economy will generate enough jobs for college graduates is up for debate—and is something of a red herring in the debate over access to higher education. What's important—and what needs to be fixed—is who gets to compete for the best jobs in America. Currently, young adults from modest backgrounds, as well as young adults of color, are much less likely to enroll and complete degrees at 4-year universities. As a result, the playing field is far from level.

Trends in College Costs

Over the last three decades, tuition at both two- and four-year public college and universities has been rising, with rapid increases in the last two decades. Since 1980, tuition at public four-year universities has more than doubled, after adjusting for inflation (see Chart 1). In 2006, the average tuition at a public four-year college was $5,836, up from $3,856 in 1996 and $2,628 in 1986 (2006 dollars). In the last five years alone, tuition has increased 35 percent, higher than any other five-year increase from 1976 to the present.[17] Tuition at community colleges has risen, though not as steeply. In 2006, the cost of tuition at two-year colleges was $2,272, up from $1,899 in 1996 and $1,227 in 1986.

Chart 1. Average Tuition and Fee Charges, 1976-2006 (2006 Dollars)

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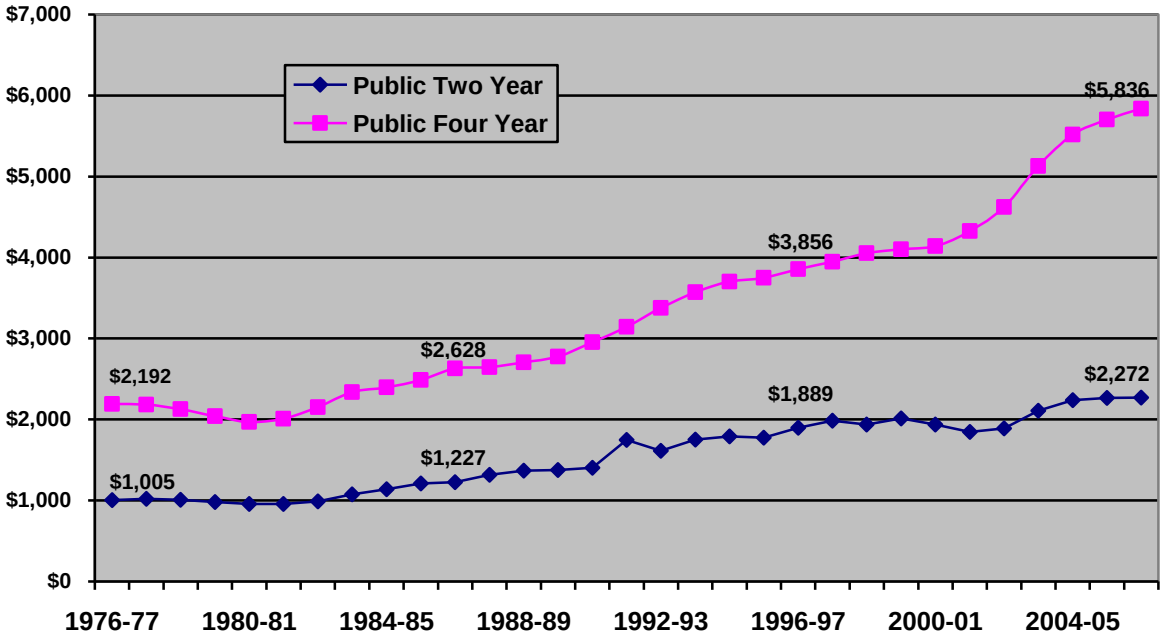

Source: College Board, Trends in College Pricing, 2006.

Tuition costs are just one aspect of the cost of attending college. Research has demonstrated that the most successful strategy for completing a college degree is full-time, on-campus study. Add in room and board charges for four-year colleges, and the total cost of attending in 2006 was $12,796, up from $9,258 in 1996 and $7,528 in 1986.

There is much debate over why tuition prices have risen so dramatically in the last decade, and certainly several factors have contributed to the rise in college costs. One contributor which is relatively undisputed is the decline in state funding of higher education. Public universities receive the majority of their operational support from state appropriations, so when states flat-line or cut appropriations, public universities make up the deficit in operational revenue by raising tuition. Over the last two decades, the level of state support has been declining. In fact, per-pupil-spending is at 25-year low. As a result, the percent of public higher education revenues from tuition has steadily increased, from 21.5 percent in 1981 to around 31 percent through the mid-1990s. After declining in the late 1990s, tuition revenues grew rapidly from 30 percent in

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2001 to 36.7 percent in 2005.[18] While the absolute dollar amounts states spend on higher education have increased over the last decade, the increase has not kept pace with either inflation or enrollments, resulting in per-pupil spending at a historic low.

Student Loan Debt and Trends in Federal Financial Aid

While increases in the published price of college have risen much faster than increases in the net price (what students actually pay after aid), student loan debt has more than doubled from $9,250 in 1993 to $19,200 in 2004.[19] The amount of student loan debt for those students graduating from public universities has also grown substantially, from $8,000 to $17,250.

Not only has the amount of debt among graduating students increased, the percentage of students who rely on student loans to finance their education has also risen. In 1993, less than half of all four-year graduates had student loans; today, nearly two-thirds graduate with debt.

Low-income students, particularly those who receive Pell grants, are much more likely to have student debt than other students. Among Pell grant recipients who earned their degree in 2004, 88.5 percent had student loans, compared to just over half (51.7%) of non-Pell recipients.[20] Pell grant recipients also carried 12 percent higher debt, carrying on average $20,735 in student loan debt versus $18,420 for non-Pell recipients.

Our nation's federal financial aid system has become a debt-for-diploma system. Over the last two to three decades, the composition of federal financial aid has shifted from a grant-based system to a debt-based system (see Chart 2). Of the $91 billion spent on federal financial aid in school year 2003-2004, only $19 billion was spent on grant aid, while loan-based aid comprised $65 billion.

Chart 2. Composition of Federal Financial Aid, 1980 and 2004.

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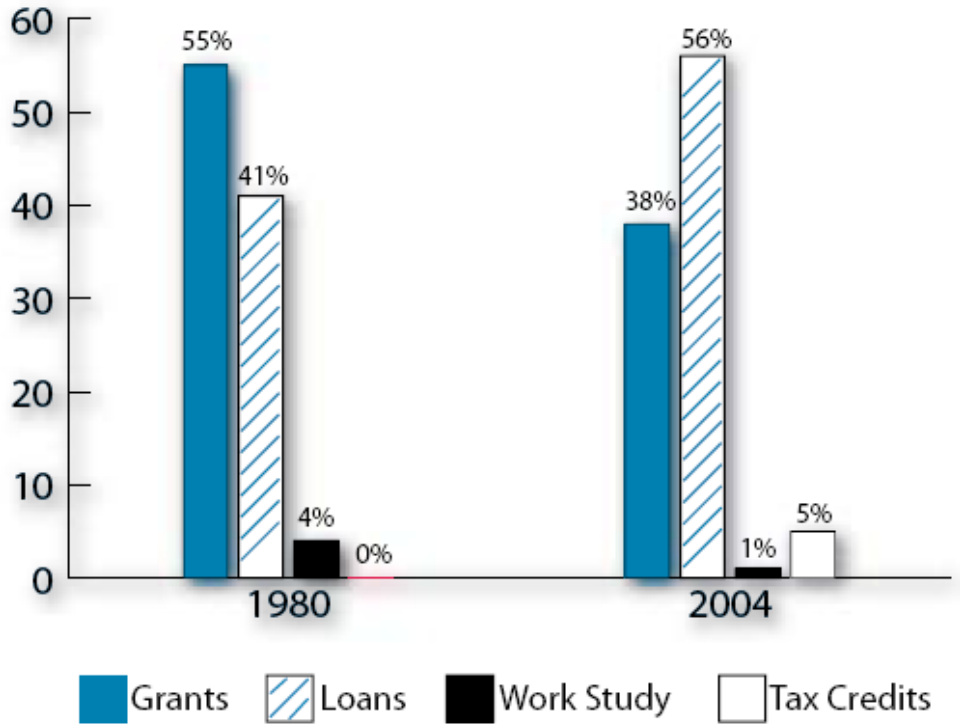

Source: College Board, Trends in Student Aid, 2004.

Not only does grant aid comprise a smaller share of the overall federal financial aid pie, its purchasing power has declined precipitously, failing to keep pace with the cost of tuition and the surge in eligible students. As a result, what grant aid is available gets spread more thinly across a greater number of students.

Today the maximum Pell Grant award—the nation's premier program for helping low-income students pay for college—covers about one-third of the costs of a four-year college today. It covered nearly three-quarters in the 1970s.[21] But only 22 percent of Pell grant recipients received the maximum award of $4,050 in 2003.[22] The average award was $2,473, which covered about one-fifth of the costs of a four-year public college.[23]

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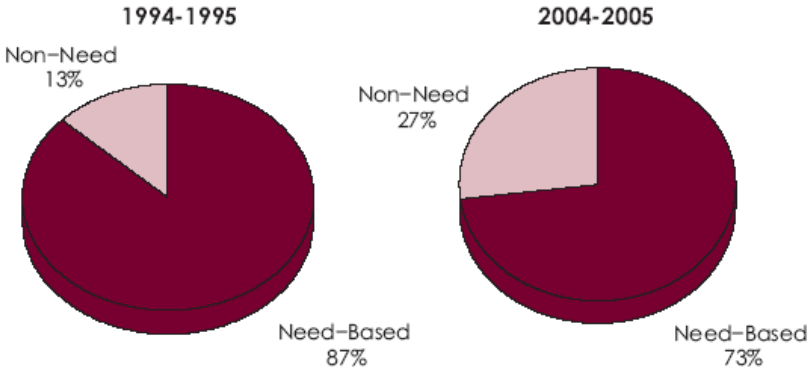
As the federal government was shifting resources away from need-based grant aid toward tax credits and debt-based aid, state governments and institutions were also shifting their aid dollars away from need-based aid (see Chart 3). Between 1994 and 2004, spending by the states on need-based scholarships for undergraduates increased by 95 percent, while spending on merit-based aid increased by 350 percent. The proportion of state grants awarded based on merit, rather than need, has risen from 13 percent to 27 percent during this period.[24] Similarly, universities have also begun using more of their financial aid resources to attract the best and brightest students—throwing increasingly percentages of aid dollars to students who could afford the cost of college without any aid. For example, in 1995, the average student from a family with an income below $20,000 received $836 in institutional grant aid, while students from families above $100,000 received an average of $239 in grant aid. In 2003, the average award to low-income students had increased 50 percent to $1,251 while the average award to students from families earning above $100,000 had grown 227 percent to $781.[25]

Chart 3. Composition of State-Based Aid, 1994-1995 and 2004-2005.



Source: National Association of State Student Grant and Aid Programs, 2005

Putting Student Loan Debt In Context

As the first generation to shoulder the responsibility of paying for college primarily by taking out loans, it's important to consider the larger economic context in which this new debt burden is

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unfolding. Some argue that the rise in student loan debt seems justified, or reasonable, given the economic benefit a college degree commands in the labor market. While it is true that someone with a bachelor's degree will earn approximately $1 million more in earnings over their lifetime than someone without a college degree, it is also true that the earnings for college graduates have remained flat for three decades (see table below). Earnings for young workers with "some college" have declined, with the typical young male worker with "some college," earning 17 percent less than the previous generation. It's important to remember that among this "some college" population are young adults who dropped out of college before completing their studies. One out of five borrowers drop out of college before finishing, leaving them with debt, but no diploma. The percentage of indebted non-completers is even higher among community college students, with one out of four borrowers dropping out without a degree.

The economic outcome of getting a bachelor degree has not risen for this generation; indeed the typical college grad is earning about the same as the previous generation. Rather, the college wage premium, as it is often called, is due to the precipitous decline in earnings power for workers with only high school degrees (see Table below).

Median Annual Earnings of All Wage and Salary Workers Aged 25 to 34 (in 2004 dollars)

	Males			Females		
	High School Dimploma	*Some College*	*Bachelor's Degree or Higher*	*High School Dimploma*	*Some College*	*Bachelor's Degree or Higher*
1974	$42,697	$44,257	$51,223	$25,913	$29,556	$35,674
1984	$36,773	$39,806	$46,775	$24,449	$28,263	$35,030
1994	$29,996	$33,650	$45,629	$22,604	$26,938	$37,363
2004	$30,400	$36,400	$50,700	$24,400	$28,800	$40,300

Source: National Center for Education Statistics, based on data from U.S. Department of Commerce, Bureau of the Census, Current Population Survey, March Supplement, 1972-2003.

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In addition to stagnant or falling incomes, today's young adults face substantially higher costs for housing and health care than the previous generation experienced during their 20s and early 30s—yet median earnings have failed to grow to accommodate either the rise in basic costs, or to accommodate the new student loan debt burden.[26]

Making College Affordable: The Contract for College

The debt-for-diploma system is a failure.

The fundamental problem is rooted in the reality that our government no longer really helps people pay for college—it helps them go into debt for college. The question we need to be asking is not "how much student loan debt is reasonable," but "what is the best way to help students afford college?" Given the enrollment gaps by income and race, in addition to the serious social consequences reported by borrowers, there is solid evidence that a debt-based aid system is not the best method for making college affordable. This is especially true when it comes to achieving the goal of making college affordable to low-income young people, for whom grant aid is the difference between enrolling or foregoing college altogether.

The last two decades have greatly heightened the demand for a highly educated workforce—and the earnings differential between those with and without college degrees has widened substantially. A college degree has become what the high school diploma was thirty years ago—the surest pathway to the middle-class. Two years of post-secondary education is now considered the minimum level of education necessary for success in this economy. A worker with a bachelor's degree now earns about 70 percent more than a worker with only a high school diploma. Over a lifetime, that wage gap will add up to over $1,000,000. Those with "some college" earn more than those who only complete high school.

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And yet, our financial aid system has become less responsive to the needs of young people, particularly those from low- to middle-income families. At a time when getting a college degree has become a near necessity for entry into the middle-class, our nation's primary ladder of opportunity is broken.

In a Dēmos report, *Millions to the Middle: Three Strategies to Grow the Middle Class*, we proposed creating a new system called the *Contract for College*. The *Contract for College* is based on a simple premise: if you study hard and are academically ready for college, money will not be an obstacle course to fulfilling your potential. The *Contract* is similar to a set of proposals made by the bi-partisan National Commission on Responsibilities for Financing Post-Secondary Education, a body mandated by Congress in 1991 through legislation sponsored by Senator James Jeffords of Vermont, then Republican.[27] The Commission's recommendations, which were never implemented by Congress, were released in a final report in February 1993.

The *Contract* would unify the existing three strands of federal financial aid—grants, loans and work-study—into a coherent, guaranteed financial aid package for students. The *Contract* would shift federal financial aid funding toward more grant-aid for students. Students from households with incomes below $25,000 would be eligible for an annual grant to cover 75 percent of the costs of attending a four-year university or $9,000, while a student from a household with income between $75,000 and $100,000 would be eligible for an annual grant to cover 40 percent of the costs, or $4,800. Part of the *Contract* for every student would include some amount of student loan aid and/or work-study requirement. But by providing grant aid for low- to middle-income students, it would end the five-figure student loan debt that stunts the progress of young adults. The table below provides an example of different *Contract for College* estimates based on family income.

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The Contract for College

Based on the average cost of annual enrollment at 4-year public colleges (approx. $12,000)

Household Income below $25,000		**Household Income between $50,000-$74,999**	
Grant to cover 75% of costs:	$9,000	Grant to cover 55% of costs:	$6,600
Work-study:	$1,500	Work-study:	$1,500
Subsidized loan:	$1,500	Subsidized loan:	$3,900
Household Income between $25,000-$49,000		**Household Income between $75,000-$99,000**	
Grant to cover 65% of costs:	$7,800	Grant to cover 40% of costs:	$4,800
Work-study:	$1,500	Work-study:	$1,500
Subsidized loan:	$2,700	Subsidized loan:	$2,350
		Unsubsidized loan:	$2,350
		Household Income above $100,000	
		Unsubsidized loan:	$10,000

The model above is for illustrative purposes. An actual plan would include more gradual phase-outs between each successive income level.

An important component in designing the program would be to ensure that families have early knowledge of the financial resources available for their children to attend college. One of the weaknesses of the current financial aid system is that parents and students do not have adequate information about the amount of aid available to them until several months before enrollment. And aid amounts tend to change from year to year. The *Contract* could allow all households with students in the 8th grade and above to receive an estimate for aid based on the average cost of attendance at public four-year institutions. For example, low-income families would be informed that they can receive a Pell grant that covers 75 percent of the cost of college, with subsidized loans and work-study to finance the rest.

In addition, the *Contract* would provide federal student loans through the Direct Loan Program, ending the Federal Family Educational Loan Program (FFELP)—the government guaranteed loan program in which the federal government acts as an intermediary between students and banks, providing massive subsidies to ensure a guaranteed rate of return to lenders. Back in 1992, Congress tried to create an alternative plan to the subsidy-rich deal for private lenders. Instead of using private lenders, the government would put up the capital for student loans and

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disburse the money directly to the college. The program, called the Direct Loan Program, started as a pilot program in 1992 and was made an option for all colleges in 1993. Unlike federally guaranteed student loans, which cost taxpayers 7 cents on every dollar, the Direct Loan program costs less than 4 cents per dollar lent.[28] By switching all federal loans to the Direct Loan Program, the Congressional Budget Office estimates that the federal government would save over billions of dollars over 10 years due to the reduction in subsidies and administrative costs associated with the FFELP system.[29] Several pieces of legislation, with bipartisan sponsorship, have been introduced to encourage schools to participate in the Direct Loan Program.[30] Based on enrollment projections, including increases due to the availability of enhanced financial aid, the rudimentary estimate of the cost of the *Contract* is approximately $48 billion per year.[31] We estimate the cost of expanded Pell grants to be $39 billion, $9 billion for work-study, and some administrative costs associated with the direct loan program.

Existing revenue for the Contract includes current spending on Pell grants of $12.7 billion. We also propose eliminating the higher education tax credits which currently cost $5.9 billion and redirecting that money to the more need-based aid system of the Contract. Additional savings would be found by switching to the Direct Loan Program. In addition there are variety of subsidies on existing loans in the FFELP system that if reduced could generate savings. For example, the special allowance payment to lenders on existing Stafford loans could be reduced by 50 basis points, as the President proposed in his budget, in addition to those on PLUS and consolidation loans. After reallocating money from existing spending on higher education programs, our cost estimates show an additional $30 billion will need to be raised.

In exchange for the federal government picking up more of the tab for college, states need to do their part to keep tuition prices under control. That means increasing, rather than decreasing, state appropriations to higher education. Over the last five years, states have consistently slashed their support for higher education as a way to deal with budget deficits. Back in the late 1990s, when states were flush with extra money, instead of stockpiling those revenues for a rainy day,

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most states enacted tax cuts. When the tech bubble burst, states were left with no reserves and the political non-starter option of raising taxes. State governments need to be more fiscally responsible about providing stable support for higher education, which is the biggest source of operating funds for state colleges.

Colleges too have an important role to play in keeping costs under check. The state university system in this nation is the envy of the world. But far too often, state colleges are racing against each other to be the best in everything, instead of concentrating on developing core academic strengths. In any given state, public universities could save the system money by eliminating duplicative programs, coordinating research expertise and collaboratively reaching agreements for each university to home in on core academic fields.

Conclusion

Congress has recently enacted legislation that would lower the interest paid on certain federal student loans. Last year, the House passed legislation that raised the maximum Pell grant. In addition, the President has proposed in his 2008 budget increasing the maximum amount of the Pell grant by $550, to a maximum of $4,600. However, neither of these reforms is adequate to address the scale of the problem that exists. In a country where higher education serves as the primary lever of economic and social mobility, the debt-for-diploma system represents a major failure. It's predicted that over the next decade more than 6 million college-ready students will fall through the cracks of the current financial aid system. Their aspirations and our future hinge on whether or not bold action is taken now to restore the ladder of opportunity, and to end the failing debt-for-diploma system.

[1] "College qualified" refers to the index of college qualification designed by the U.S. Department of Education's National Center for Education Statistics (NCES). The index evaluates high school seniors on cumulative academic coursework GPA, senior class rank, NELS test scores, and SAT and ACT college entrance examination scores. "Low-income families" refer to households with incomes below $25,000. "Moderate-income families" refer to households with incomes between $25,000 and $49,999.

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[2] Postsecondary Education OPPORTUNITY, Unmet Financial Need, Student Work/Loan Burden and Net Price to Family for Dependent and Independent Undergraduate Students by Institutional Type/Control and Parental/Family Income Quartiles, 2004, October 2005.
[3] *Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity,* (Washington, D.C.: Advisory Committee on Student Financial Aid Assistance, February 2001).
[4] Ibid.
[5] Ibid.
[6] Richard D. Kahlenberg, ed., *America's Untapped Resource: Low-Income Students in Higher Education* (New York: Century Foundation Press, 2004), p. 22.
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[26] Tamara Draut, *Strapped: Why America's 20- and 30-Somethings Can't Get Ahead* (Doubleday: 2006).
[27] The Commission's final report *Making College Affordable Again* was released in February 1993. The report identified specific policy concerns, which led to the formulation of policy recommendations, including the Student's Total Education Package (STEP). The Commission's full report is available online at http://www.ihep.org/Pubs/PDF/makingcollegeaffordable.pdf.
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[30] See Sharkey, 2005. According to Sharkey, Rep. Thomas Petri (R-WI) and Rep. George Miller (D-CA) have introduced the Direct Loan Reward Act, which would establish incentives for colleges to switch to the Direct Loan program by offering to let them keep half of the savings for their use in financial aid programs. The bipartisan Student Aid Reward Act, introduced by Rep. Petri, Rep. Miller, Sen. Edward Kennedy (D-MA) and Sen. Gordon

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Smith (R-OR), asks the Secretary of Education to determine which student loan program is less expensive, and then provides additional scholarship money to schools that adopt the cheaper loan program.

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