Reinventing Chapter 1: The Current Chapter 1 Program and New Directions

Final Report to the National Assessment of the Chapter 1 Program

U.S. Department of Education

Briefing on the Final Report of the National Assessment of Chapter 1

U.S. Department of Education
1993

Issues to be addressed in this briefing:

- What is Chapter 1?
- How well is it working?
- Why reinvent Chapter 1?
- What are recommended new directions?

What is Chapter 1?

- Financial assistance to school districts with *high concentrations of low-income children* for instructional programs to meet the needs of *educationally disadvantaged* children.

- The federal government's largest investment in elementary and secondary education, accounting for *19 percent* of the U.S. Department of Education's total budget.

- *$70 billion* appropriated since the program's inception in 1965--$6.1 billion in FY 93 to serve over *5 million children.*

- Predominately a program for *elementary school students.* In 1990-91, 70 percent of participants were in grades 1-6.

Chapter 1 Participation by Grade Span
1990-91

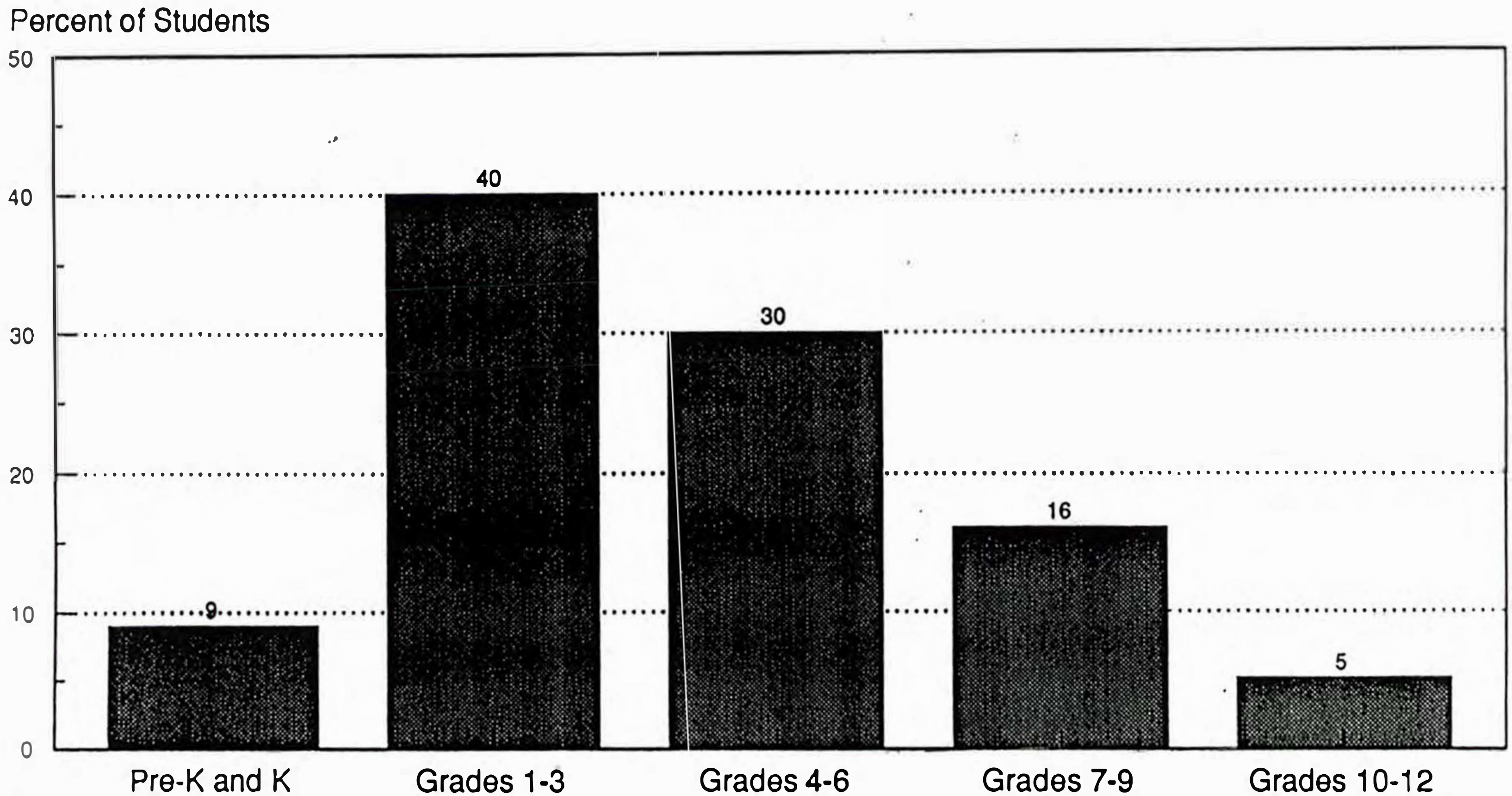


Exhibit reads: Chapter 1 participation is concentrated in the elementary grades with 70 percent of Chapter 1 of all students in grades 1-6.

Source: Summary of Chapter 1 Participation and Achievement Information, 1990-91, Unpublished tabulations (Sinclair & Gutmann, 1993).

What were the new features of the Hawkins--Stafford Amendments?

Congress reauthorized Chapter 1 as part of the Hawkins--Stafford Elementary and Secondary School Improvement Amendments of 1988. Congress enacted provisions designed to:

- Strengthen accountability for student outcomes via *program improvement*;
- Encourage flexibility through *schoolwide* projects in high-poverty schools;
- Emphasize the teaching of both basic and more *advanced skills*;
- Improve the targeting of resources by *strengthening concentration* grants;
- Offer intergenerational educational services to disadvantaged young children and their parents through the creation of the *Even Start* program; and
- Defray the cost of serving students in private religiously affiliated schools by adding *capital expenses* funding.

How well is Chapter 1 working?

Chapter 1 has helped close the learning gap between disadvantaged and more advantaged students, but has gone about as far as it can go.

Although longitudinal data are available for only one year, the evidence indicates that Chapter 1, as it is currently configured, cannot enable students to achieve the high standards set by the National Education Goals. Keeping in mind that Chapter 1 is not a monolithic program and that averages mask individual outstanding projects,

- Chapter 1 participants did not improve their relative standing in reading and math in the fourth grade and in math in the eighth grade; only eighth grade reading participants showed any improvements.

- Overall differences were minimal in gains between Chapter 1 participants and nonparticipants matched on student background.

- The percentile level of students in high-poverty schools declines at higher grades, indicating that schools are unable to close the learning gap.

TRENDS IN AVERAGE READING PROFICIENCY OF 9-YEAR OLDS BY RACE/ETHNICITY, 1971-1990

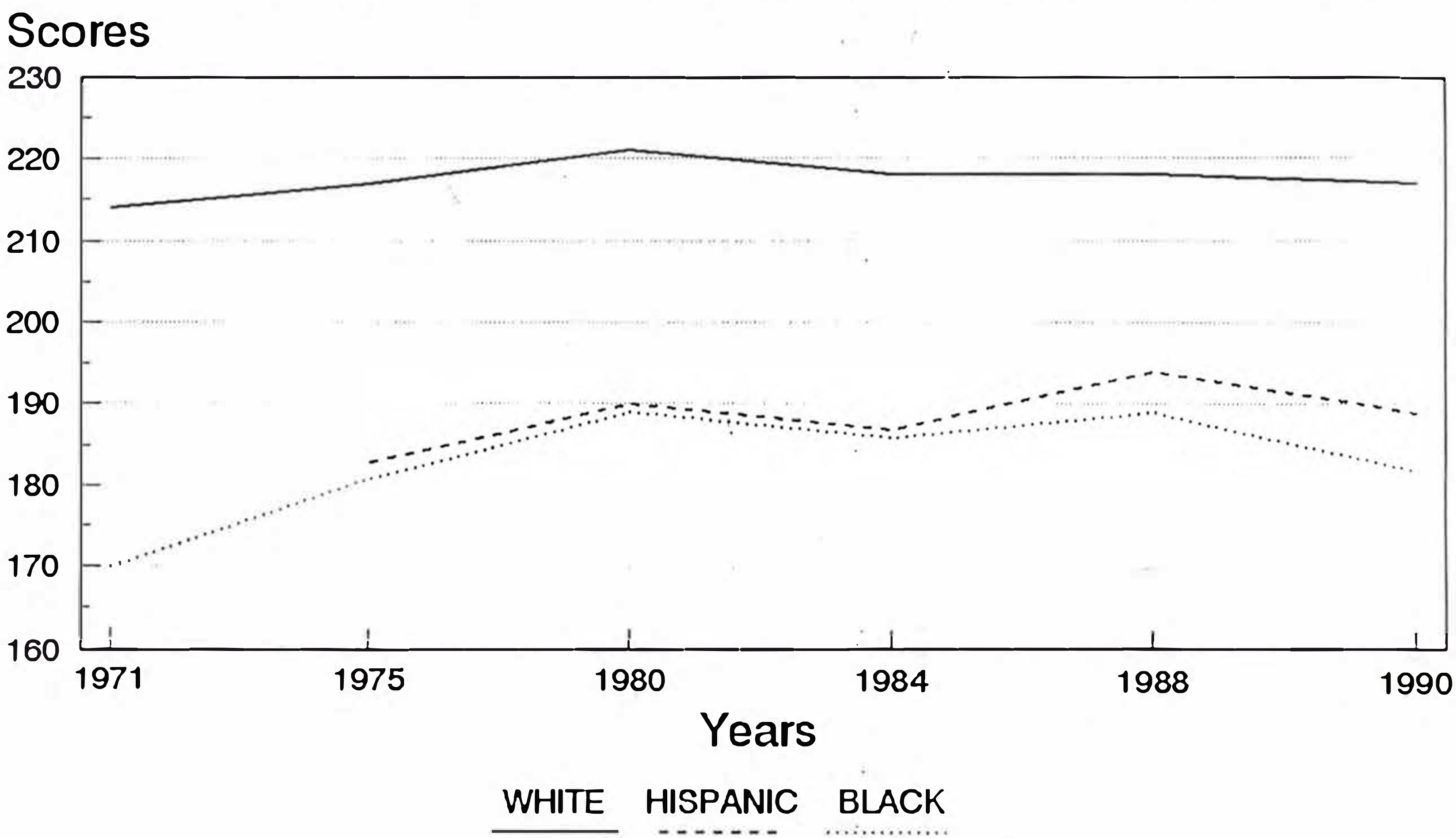


Exhibit reads: During the 1970's minorities made gains in closing the learning gap in reading.

Source: National Assessment of Educational Progress, 1991.

Reading Scores, Third to Fourth Grade, of All Students and Chapter 1 Participants

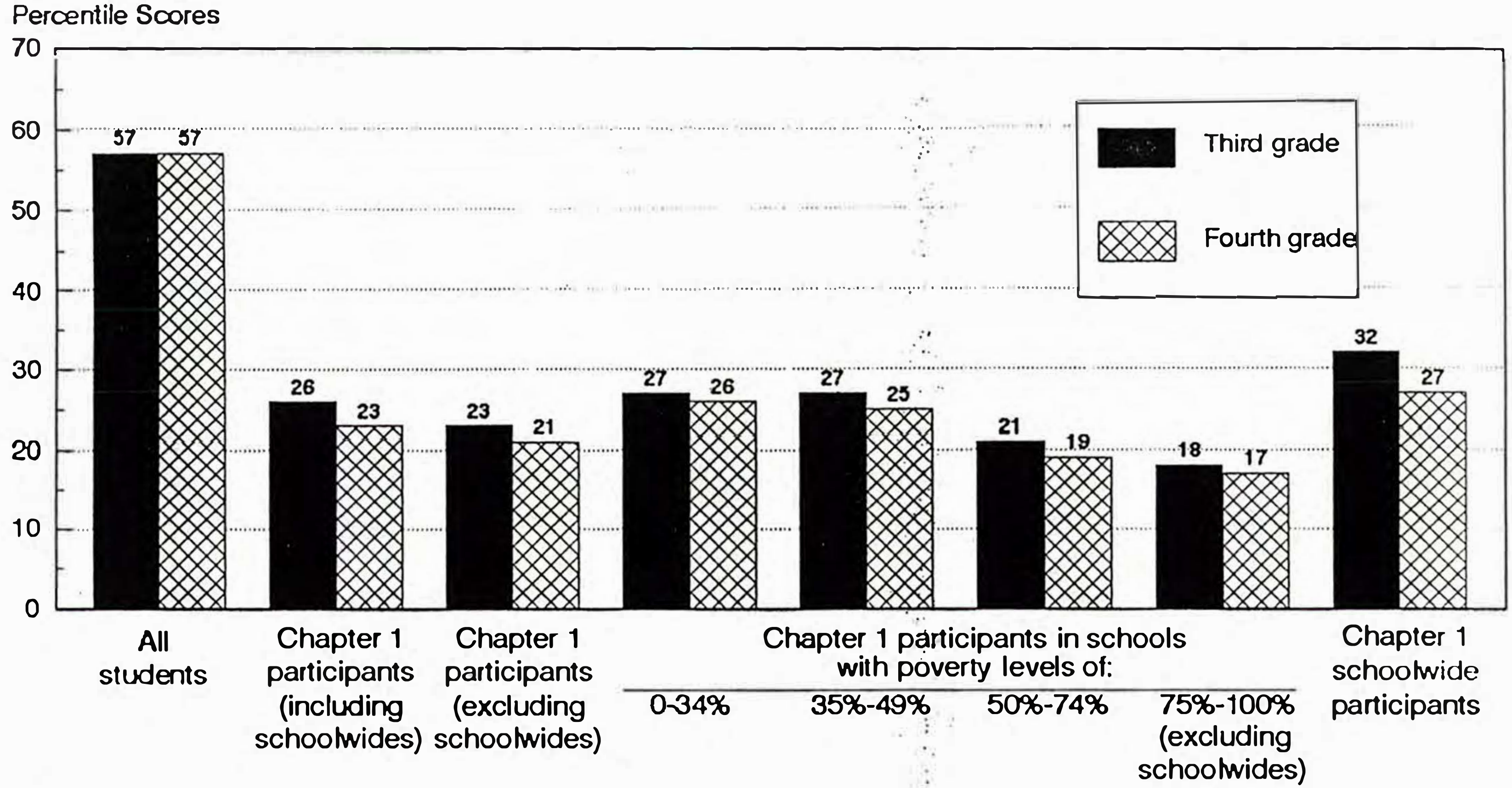


Exhibit reads: The reading scores for Chapter 1 participants in the third and fourth grades were in the bottom quarter for students nationally. Chapter 1 students in high-poverty schools had the lowest scores.

3rd4th_1.drw

Source: Prospects (Abt Associates, 1993).

Exhibit 1
Achievement Scores in Percentiles, by Level of School Poverty: Grades 1, 3, 4, 7, and 8

Grade	Reading, by Level of School Poverty					
	All Schools	0-19%	20%-34%	35%-49%	50%-74%	75%-100%
1--Fall '91	51	60	58	50	45	33
3--Spring '91	57	66	60	55	47	30
4--Spring '92	57	67	60	55	46	28
7--Spring '91	55	66	64	50	38	21
8--Spring '92	56	65	65	50	40	22
Math, by Level of School Poverty						
	All Schools	0-19%	20%-34%	35%-49%	50%-74%	75%-100%
1--Fall '91	55	66	64	50	46	34
3--Spring '91	57	66	60	53	52	33
4--Spring '92	55	65	57	52	46	29
7--Spring '91	54	65	61	50	42	24
8--Spring '92	52	63	60	46	41	24

Exhibit reads: On the fall reading test, first graders in low-poverty schools on average performed better than 60 percent of students in the nation.

Source: Prospects (Abt Associates, 1993).

Note: Percentiles should be interpreted as scoring above a given percentage of students nationally.

Why reinvent Chapter 1?

Currently, Chapter 1 *works on the margins*, focusing on basic skills.

- Although in-class instruction has risen since 1985-86, 70 percent of regular classroom teachers report that Chapter 1 participants are pulled out of regular instruction for services.

- Chapter 1 instruction is generally 30 minutes a day but adds only an average of about 10 minutes of extra instructional time.

- Extended learning opportunities through before-or after-school programs or summer school are rare (9 percent and 15 percent of programs, respectively).

- Chapter 1 employs about as many aides as teachers, many of whom provide direct instruction. However, over 80 percent of aides only have a high school diploma.

Main Activities Missed When Public Elementary Students Receive Chapter 1 Reading/Language Arts and Mathematics Services, As Reported by Classroom Teachers, 1991-92

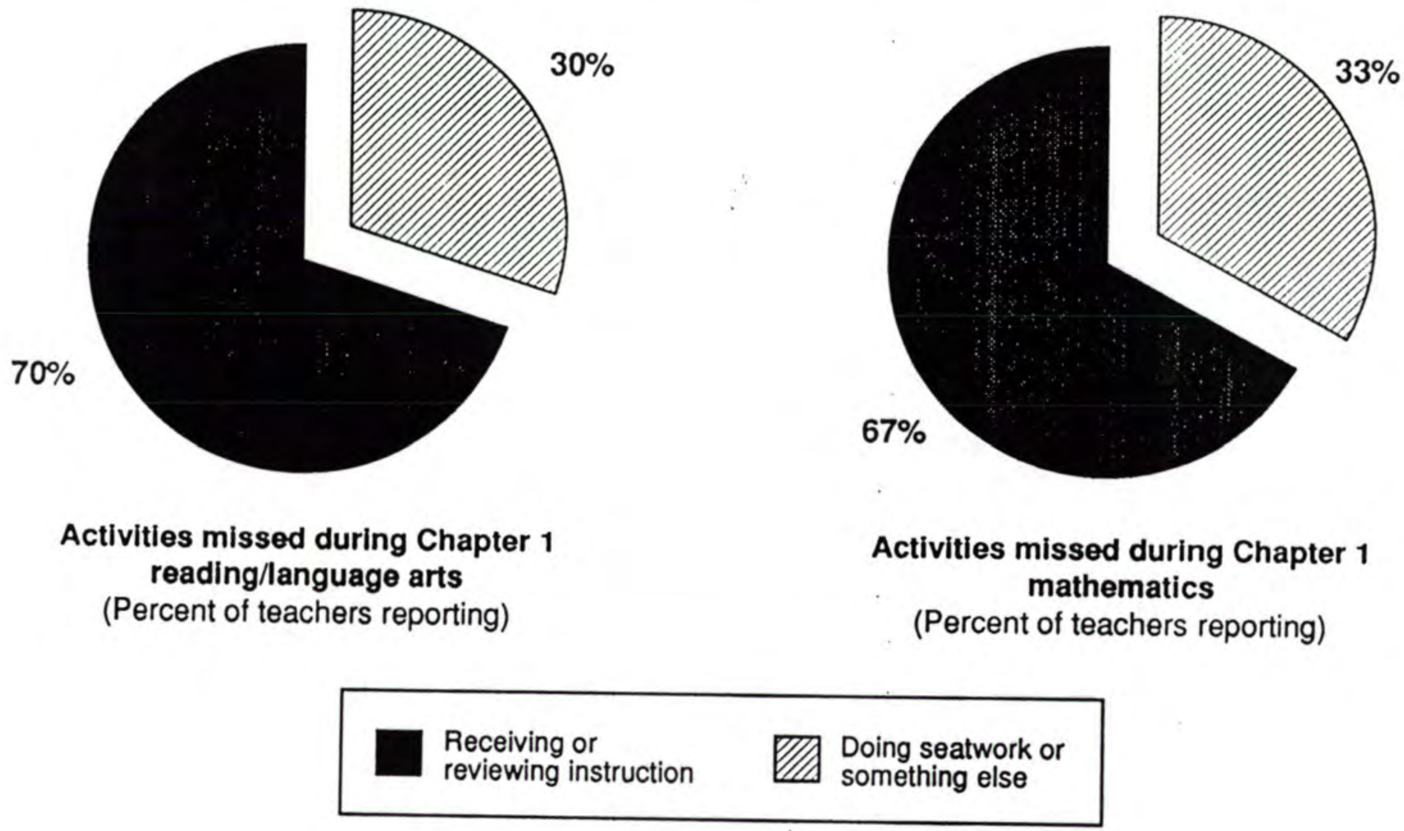


Exhibit reads: Seventy percent of classroom teachers report that students miss basic instruction when they receive Chapter 1 reading/language arts services.

Source: Chapter 1 in Public Schools: The Chapter 1 School Implementation Study (Millsap, Moss, & Gamse, 1992).

Why reinvent Chapter 1?

Poor targeting.

- Almost *all districts* (95 percent) receive Chapter 1 funds, and *half of all schools* (50,000) receive Chapter 1.

- Fourteen percent of high-poverty elementary schools receive no Chapter 1 funding, and half the low-achieving children in high-poverty schools *do not receive Chapter 1 services*.

- Students in high-poverty schools typically *score about the same* as Chapter 1 participants in low-poverty schools. Chapter 1 students in the high-poverty schools score well below other Chapter 1 participants.

Reading Scores for All Students and Chapter 1 Participants, by Level of School Poverty: Fourth Grade, Spring 1992

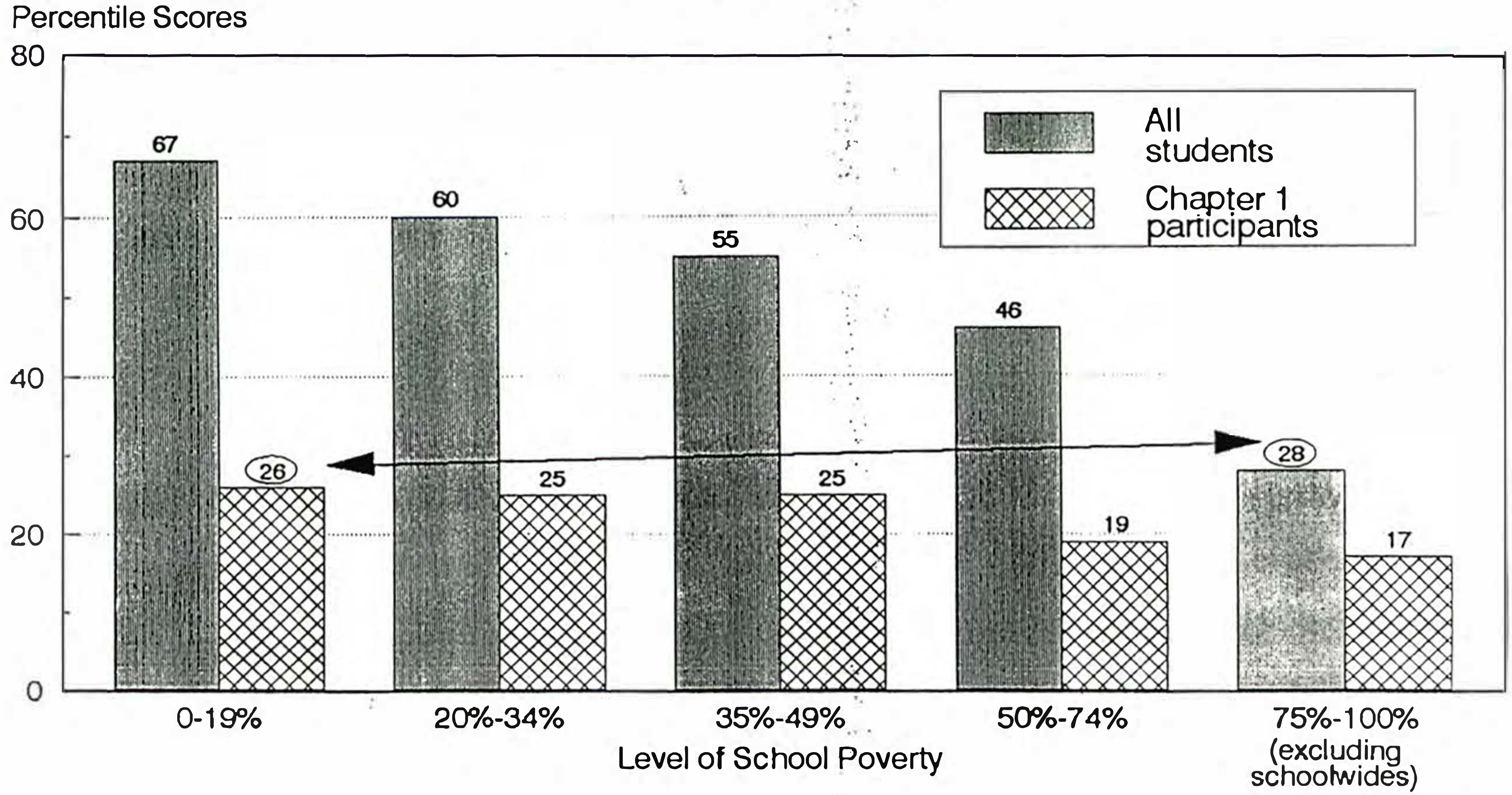


Exhibit reads: Students in high-poverty schools typically score about the same as Chapter 1 participants in lower-poverty schools. Chapter 1 students in the high-poverty schools score well below other Chapter 1 participants.

Source: Prospects (Abt Associates, 1993).

allread.drw

Why reinvent Chapter 1?

The needs are great.

Benchmarking the performance of students in high-poverty schools (75 percent or more poor children) with their counterparts in low-poverty schools (less than 20 percent poor children) against the National Educational Goals:

- *Goal 1*: More than a fifth of the first-graders in high-poverty schools are perceived by their teachers as having general health problems, almost twice the percentage in low-poverty schools.

- *Goal 2:* Students in high-poverty schools (50 percent or more poor) are 57 percent more likely to leave school by grade 10 than students in low-poverty schools (6-20 percent poor).

The needs are great (cont.)

- *Goals 3 and 4:* First graders in high-poverty schools start school scoring 27 and 32 percentile points lower in reading and math, respectively, than their peers in low-poverty schools. High-poverty schools appear unable to close the initial gap which increases in both grades 4 and 8.

- *Goal 5:* One-third of parents in high-poverty schools lack a high school diploma compared with only 3 percent in low-poverty schools.

- *Goal 6:* 81 percent of students in high-poverty schools have principals who see physical conflicts as a problem compared with 31 percent in low-poverty schools.

Why reinvent Chapter 1?

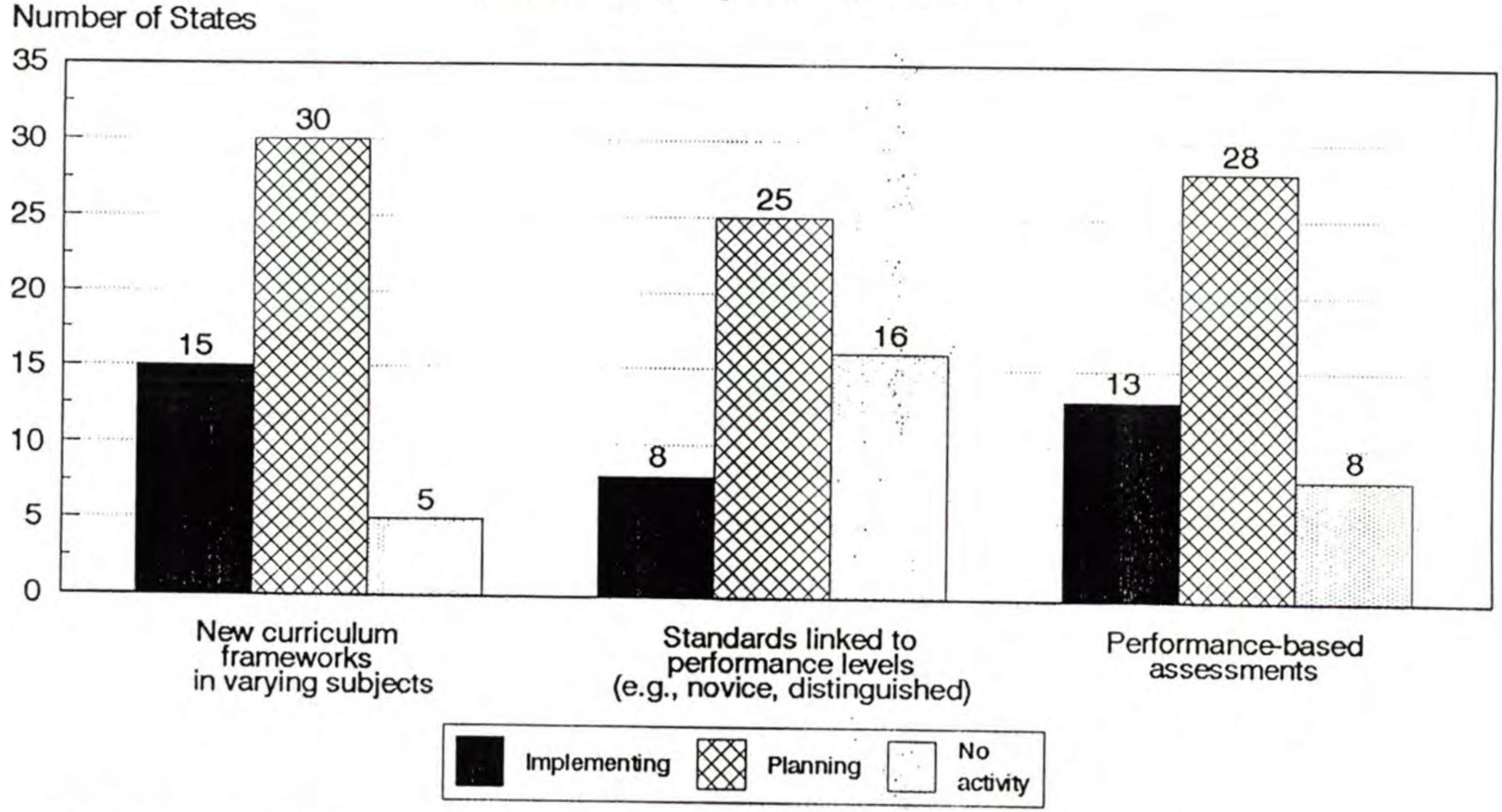
Student assessment and accountability not linked to the curriculum.

- Chapter 1 is one of the largest testing programs in the country, requiring testing of over 5 million students each year.

- National accountability drives testing by requiring comparable data across States using normed-referenced tests. States that are working toward content-based standards and newer assessment methods, are nevertheless compelled to use normed-referenced tests.

- The national aggregation of individual test score information has yielded inflated and incomplete information virtually useless for either policymaking or program management.

Status of New Curriculum Frameworks, Standards, Assessment, and State Monitoring Systems, 1992-93



Note: Data are for the 50 states, the District of Columbia, and Puerto Rico. In some cases, no information was available, so the data do not sum to 52.

Exhibit reads: Fifteen states are implementing new curriculum frameworks.

Source: Status of New State Curriculum Frameworks, Standards, Assessments, and Monitoring Systems (Pechman & LaGuarda, 1993).

Why reinvent Chapter 1?

Program improvement set low standards.

- In 1991-92, 27 out of 50 states ***required only that achievement gains must exceed zero percentiles.*** This is an improvement from 1989-90 when 36 states set improvement at the statutory minimum. Change scores are a problem because schools with high achievement but slight declines are identified for improvement, schools with low achievement but meager progress are not.

- About ***half the schools tested out of program improvement*** without ever implementing an improvement plan.

- ***Written plans are vague***, fragmented and rarely describe specific objectives.

Why reinvent Chapter 1?

Technical assistance spread too thinly; monitoring focuses on compliance.

- With small resources (0.1 percent of Chapter 1), Chapter 1 technical assistance centers ***provide short-term assistance across a broad variety of strategies,*** rather than covering topics in depth. Schools rely primarily on local sources for assistance.

- According to local Chapter 1 directors, much of their assistance from SEAs ***focuses on regulatory matters of program compliance*** (60 percent) rather than program quality (34 percent).

If we are to expect the children served by Chapter 1 to reach the National Education Goals adopted by the president and the nation's governors in 1990, fundamental changes to the program will have to occur.

The Chapter 1 program should be a model that adheres to the highest standards for curriculum and instruction, driving the strategies of other education programs, rather than one that follows outdated methods or lags behind national reforms.

What are new directions for Chapter 1?

Operating as a separate supplemental program, Chapter 1 has gone about as far as it can go in raising the skills of at-risk students. To prevent children in high-poverty schools from being left behind, Chapter 1 must support:

- High standards -- the same expected of all children

- Strategies that support high standards
  - -- intensive staff development and assistance
  - -- monitoring and enforcement that focus on continuous progress
  - -- assessment tied to curriculum
  - -- integration of education and social services in high-poverty schools.
  - -- expansion of family involvement

- Concentrated funding to provide the resources to affect changes in high-poverty schools

Seventh-Graders' Grades and Percentile Test Scores: Low- and High-Poverty Schools, 1991

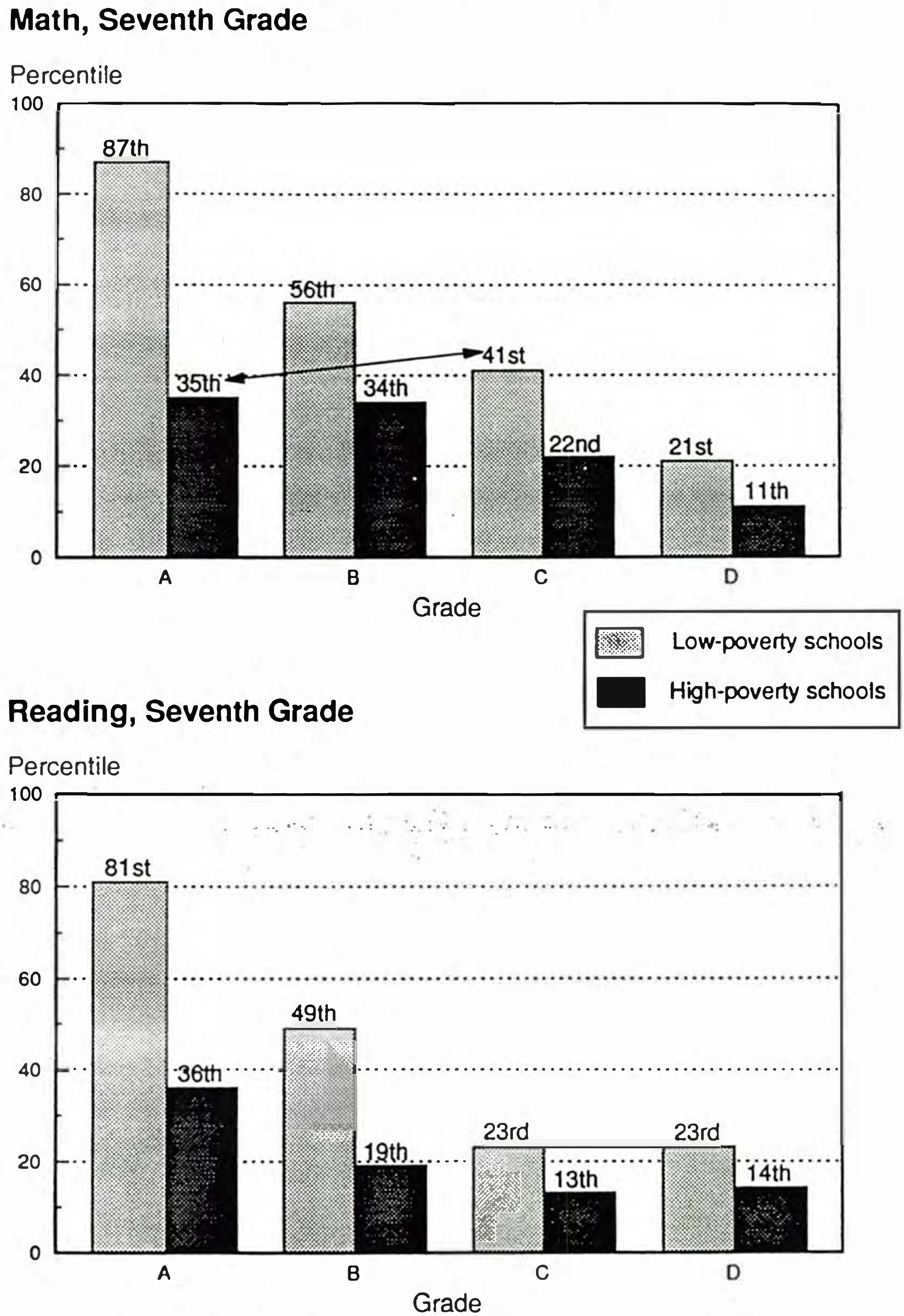


Exhibit reads: An A student in a high-poverty school would be about a C student in a low-poverty school when measured against standardized test scores.

Source: Prospects (Abt Associates, 1993).

Reading and Math Percentile Bands for
All Schools and Schools with 75-100 Percent Poverty

SCHOOL SCORES	READING PERCENTILES		MATH PERCENTILES	
	All Schools	High Poverty	All Schools	High Poverty
First Grade				
Mean	38	26	35	25
Maximum	86	72	82	72
Fourth Grade				
Mean	40	24	38	26
Maximum	86	50	90	58
Eighth Grade				
Mean	38	24	36	24
Maximum	74	60	78	63

Exhibit reads: First grade students in one high poverty school in the Prospects sample scored at the 72nd percentile. Indeed, these top performers could set an interim benchmark for similar schools to target.

Source: Prospects (Abt Associates, 1993).

Consumer Confidence Index Slips

Data a New Sign Of Halting Recovery

By Steven Pearlstein
Washington Post Staff Writer

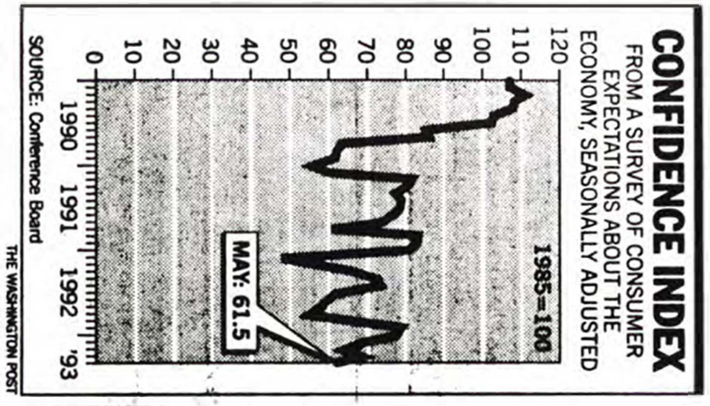
Consumers' confidence in the economy continued to slide this month, the Conference Board reported yesterday, the latest sign of a halting recovery from the recession that ended nearly two years ago.

The decline in the index of consumer confidence was the fourth drop in five months following a brief Christmas euphoria that saw a surge in consumer spending. The May reading of 61.5 now stands at its lowest point since last October. A 100 reading reflects the confidence levels of 1985.

"The whole issue now is jobs—we see it clear as a bell," said Fabian Linden, who directs the monthly study at the Conference Board, a private business research organization. The report showed that only one in eight Americans expects the job market to grow in the next six months.

Even people with jobs are ner-

See ECONOMY, F4, Col. 3



Wednesday, May 26, 1993 The Washington Post

Index of Consumer Confidence Continues Slide

ECONOMY, From F1

vous, Linden said, as they see their colleagues and neighbors losing jobs at supposedly solid companies and graduating students unable to get jobs. "There's a lot of anxiety out there," he said.

Speaking to a Dallas gathering of business leaders yesterday, Federal Reserve Chairman Alan Greenspan said conditions are ripe for a major expansion in job growth, predicting an end to large-scale layoffs as the nation's corporate downsizing frees up new money.

"What history tells us is that this is the early stage of a major expansion in employment," he said.

Bond prices tumbled in late trading after the Fed chairman made his comments. Traders apparently interpreted them as raising the specter of higher inflation, which hurts the value of bonds.

Treasury Undersecretary Lawrence H. Summers said yesterday the halting nature of the economic recovery was still more of a threat to the economy than inflation.

"There is more room on the down side for disappointment than there is room on the up side for too rapid growth," Summers told the Senate Banking Committee.

Economists pay particular attention to consumer confidence because it closely tracks consumer spending, which has been flat or declining since January as households have used what extra money they have to pay on the large bills they rung up at Christmas.

Yesterday's report on consumer confidence mirrors a similar survey of business managers released Monday by Cahners Economics Inc., which registered the third monthly decline in business confidence since February.

According to the survey, which focuses on goods-producing sectors of the economy, only half of the 400 executives surveyed rated the current business climate positively, down from 64 percent in February.

But neither the business nor consumer confidence report were unequivocal in their pessimism.

In spite of their pessimism about employment and income over the next six months, the percentage of consumers who expect to buy a new car, home or major appliances rose this month—a reflection, said analysts of pent-up demand after months of putting off such purchases.

And despite the gloomier outlook by business executives, there were six companies planning to expand payrolls next month for every one that was planning to cut back.

"So what's new?" said Samuel D. Kahan, chief economist at Fuji Securities Inc. "We continue to muddle along."

Analysts said the government bears some responsibility for waning confidence, citing disenchantment with the drift of economic policy-making following what seemed to be the strong initial push behind President Clinton's economic and budget plan.

"The bloom is off the flowers in the Clinton Rose Garden," said Stephen Roach, chief economist at Morgan Stanley & Co., who said concerns about higher taxes and the cost of health care reform hang over consumers and businesses alike.

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Simon Attacks Lobbying By Student Loan Industry

By Michael Weisskopf
Washington Post Staff Writer

Written in campus patois, the posters handed out at colleges across Ohio last week warned darkly that President Clinton's plan to overhaul the national student loan program was "kind of like pass-fail with your future on the line." Pre-addressed postcards to both of Ohio's U.S. senators were attached, pleading for a "no" vote on the measure. An 800 number was given in bold print to "register your concerns by phone."

Although the credit line in small print read "Ohio Students for Loan Reform," appearances often can be deceiving in the murky world of "grass-roots" lobbying.

The organization actually is run out of the Cincinnati offices of Student Loan Funding Corp. (SLFC), a secondary market for student loans that would lose the core of its business if Congress passes Clinton's plan for direct government lending to students. SLFC paid for the posters and contracts out the toll-free phone line.

Far from Washington, the Ohio effort is designed to augment the work of powerful lobbyists here, hired by such financial giants as the Student Loan Marketing Association (Sallie Mae) to preserve a system that costs taxpayers about $5 billion a year.

Clinton criticized Sallie Mae May 11 for piling up excessive profits and for trying to block his proposal. Yesterday, Sen. Paul Simon (D-Ill.), chief sponsor of the direct loan plan, joined the attack at a Capitol Hill news conference where he disclosed the Ohio effort, calling it a "sham" group and "the latest outrage in an all-out lobbying campaign orchestrated by Sallie Mae and its allies."

Simon implied that the industry was using student "fronts" in more states than Ohio, and he presented a University of Wisconsin student leader who said that Sallie Mae had tried to enlist him to set up a similar organization on his Madison campus—a charge denied by the institution.

Sallie Mae and SLFC were created by Congress to implement the existing student loan program. They are known as secondary markets, which raise money at favorable rates because of their government imprimatur and use the funds to buy government-guaranteed student loans from commercial lenders, thus keeping capital flowing through the student loan market and ready for new student borrowers.

Because the interest they earn on student loans they buy is higher than they pay to raise the money, the institutions profit handsomely—$394 million for Sallie Mae last year. The money is distributed as dividends to shareholders and made possible compensation of up to $2.1 million in 1991 for its chief executive officer.

Clinton claims that with student loans obtained directly from the federal government, his plan would cut out the profit-making middle men, saving the government $1 billion a year in excess interest, administrative costs and loan defaults.

Sallie Mae and the state institutions such as SLFC technically compete against each other in the secondary market. But they have allied to fight Clinton's proposal and put together a lobbying juggernaut, leading critics in Congress to question the principles of an industry created and largely subsidized by the federal government.

Some of the most powerful lobbying firms in Washington have been hired to stop direct loans. Sallie Mae employs Williams and Jensen and the Cushenberry Group to lobby, and the Wexler Group, well-connected with Democrats in Congress, to help plot strategy. Other firms such as Patton Boggs & Blow, O'Connor & Hannon, Walker/Free Associates, and Akin, Gump, Strauss, Hauer & Feld have been hired by lenders and second market institutions to fight the Clinton plan.

SLFC, which has three firms lobbying here to protect its business of $200 million a year in student loans, set up the "Ohio Students" group in April and spent about $25,000 on ads in student newspapers, posters, the 800 line and a salary for a student who coordinates it, said Mark Weadick, the chief financial officer.

He said the idea came from Andrew Goldner, a University of Cincinnati student who opposes direct student lending and agreed to work part time for SLFC for $7 an hour to organize student opposition at more than a dozen Ohio colleges.

Weadick said that the materials did not reflect his company's sponsorship because of an oversight and that Goldner always reveals his backers when he is asked.

"It's never been our intent to mislead anyone in any way," said Weadick in a telephone interview. "We believe that students and their families are the true constituents, and they don't have the resources to make their views known."

At yesterday's news conference, Robert Kraig, a Wisconsin graduate student, said that Sallie Mae flew him and a friend here May 17 and arranged a meeting at its Georgetown offices with the institution's top legislative officials.

A Sallie Mae spokeswoman said the students were flown in to hear "our perspective" on the issue, and they were shown the Ohio materials. But she denied that they were asked to form a similar group or offered funds for such a group.

"We've never been and never will be engaged in activities of that nature," she said.

Staff writer Albert B. Crenshaw contributed to this report.

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UNITED NEGRO COLLEGE FUND
500 East 62 Street, New York, New York 10021
(212) 326-1111

March 18, 1993

William H. Gray, III
President
Chief Executive Officer

Dr. Robert Atwell
President
American Council on Education
One Dupont Circle, NW
Washington, DC 20036

Dear Bob,

I am writing to ask that you convene a meeting of the major presidential associations -- as soon as possible -- regarding the issue of national service and its relationship to "direct lending." As I believe you know, President Clinton discussed frequently, during the 1992 presidential campaign, and more recently during a speech at Rutgers University -- the importance of providing a national program of national and community service -- and some form of loan forgiveness for college students. The exact parameters of this concept are unknown at this time. UNCF's presidents, meeting in New York last week, have agreed to oppose mandatory direct lending and to recommend to the Congress a modified approach with regard to the President's National Service Trust Fund proposal. (see enclosed)

It is clear, however, to UNCF presidents that national service is a potentially expensive undertaking, and that a costly new program could compromise the viability of the current Title IV, Student Assistance programs, especially Pell Grants. Further, linking national service to direct loans may cripple smaller institutions of higher education, like the United Negro College Fund (UNCF) member institutions, and two and four-year public institutions with small student aid offices, in their ability to serve low and middle income students.

Notwithstanding UNCF's concerns in this area, I believe that the entire higher education community would be best served if we all sat down and discussed the pros and cons and the potential impact on students and our institutions. If we could find consensus, together we could persuade the President, or at least influence the formal development of the Administration's proposal. In addition to the "Big Six," I want to strongly recommend

Dr. Robert Atwell
March 18, 1993
Page two

that the following persons be invited, in addition to myself – Dr. Samuel L Myers, NAFEO; Dr. Laudeline Martinez, HACU; Dr. A. Dallas Martin, NASFAA; Dr. Arnold L Mitchem, NCEOA; and Dr. Caspa Harris (NACUBO). You may want to include others.

I will be calling you within the next few days to discuss your reaction to my suggestions.

Sincerely,

Bill

William H. Gray, III

Enclosure

cc: Dr. Samuel L Myers

UNCF STEP/NATIONAL SERVICE COMPROMISE PR[illegible]

1. Guarantee all students a $14,000 Title IV, student aid package if they are "independent" or are dependent with a family income of $50,000 or less, AGI. The STEP concept of providing a balanced package of work (CWS), grant (PELL), and loans (Stafford/GSL and PLUS or SLS (unsubsidized)) would be retained with grant aid emphasized in the $14,000 package for the lowest income students and loans -- both subsidized and unsubsidized -- for students from higher income families. UNCF will develop a table, for inclusion in the law, which will determine the apportionment of grant, work and subsidized loan assistance to be received by eligible students according to family income. The inflation adjusted nature of the $14,000 package would specifically be implemented.

2. The Supplemental Educational Opportunity Grant (SEOG) program would be merged into the PELL Grant program. The Perkins Loan program's Federal capital contribution to eligible institutions would be terminated. Institutions could continue to collect Perkins Loans and make new loans to "needy" students and to all students who expect to enter the teaching profession.

3. The President's National Service Trust Fund (NSTF) would be implemented by providing unsubsidized loans through existing lending capital sources to students from all income groups, with unsubsidized loans being available only to those from students with families with incomes above $75,000; students from families with incomes between $50,000 and $75,000 would be eligible for both subsidized and unsubsidized loans if they agree to perform qualified national service; loans would be limited to the cost of tuition; students would be required to do one year of qualified national service for every year of loan assistance received (deferments would be available for students enrolling in graduate or professional school to pursue an advanced degree); eligible students would be referred to a "qualified" national service opportunity provided by existing non-profit and state/local government agencies, or to Federal programs operated by the ACTION Agency, e.g., Peace Corps, VISTA, or the Department of the Interior (Civilian Conservation Corps), or the Department of Labor (Job Corps).

4. Student lending capital would continue to be provided from existing private sources, with any institution of higher education desiring to make "direct" loans to its students having the option of securing that capital through the private markets, Student Loan Marketing Association or any state or regional secondary market. Institutions of higher education which elect to provide direct loans would be compensated through an administrative payment from the Department of Education for each loan disbursed to an eligible student in order to off-set the personnel and other administrative costs associated with direct lending. The Direct Lending Demonstration authorized in the Higher Education Act Amendments of 1992 would be repealed.

[illegible].ATT
REV 3/17/93

March 24, 1993

MEMORANDUM FOR CAROL RASCO

FROM: ELI SEGAL

SUBJECT: Potentially Conflicting Policy Directions

In the last two weeks, our concern has grown regarding potentially conflicting policy initiatives. Two in particular seem to place the President's national service initiative in some jeopardy with Congress.

First, the President's program since the campaign has inextricably linked national service with student aid reform. Accordingly, all interested education groups have examined the initiative as part of a package of Executive branch actions. Recognizing that the national service program is not expected ever to involve many more than 150,000 individuals at one time, and that the number of Pell Grant recipients greatly exceeds that number, Pell Grants have a large and important constituency in the country, as well as on the Hill. Although the Administration has funded the deficit left from its predecessor for Pell Grants, there is no proposal to achieve the authorized funding level of $3,700 per student (which is currently appropriated only to $2,300 per student), and we have been told that approximately 72,000 students from families with family incomes between $30,000 and $50,000 will be denied Pell Grant eligibility to preserve the Grants for all students with family incomes under $30,000.

These actions may well be seen as a scaling back of the federal government's commitment to the principal form of student aid. Because the national service initiative calls for substantial new spending, we worry about funding being achieved at the expense of the existing student aid programs. Several key constituencies behind the broad support for national service will be nearly certain to abandon the effort if national service is pitted against Pell Grants.

Second, the principal delivery mechanism applying national service volunteers to the Nation's unmet problems is the not-for-profit community. That community is concerned about proposed Treasury regulations which would make changes in the nature and extent of charitable deductions, having the unintended effect of significantly reducing private funding for these organizations. If this source of funds is removed by the Treasury, we may be faced with the prospect of either not having enough qualified programs in place that are able to receive the volunteers we will have stimulated with our national service initiative, or of having to replace private sector donations to the non-profits with federal program funds.

We would appreciate your recommendation of the best venue for ensuring that these and other cross-cutting policy issues are fully discussed within the Executive branch, for greatest possible coordination. Let's discuss how best to proceed.

cc: Bill Galston
Shirley Sagawa
Rick Allen
Jack Lew

Hillary, fyi –

Bill Gray's letter illustrates the importance of continuing to fully fund Pell Grants. Otherwise, there will be opposition to the new nat'l service initiative.

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Notwithstanding UNCF's concerns in this area, I believe that the entire higher education community would be best served if we all sat down and discussed the pros and cons and the potential impact on students and our institutions. If we could find consensus, together we could persuade the President, or at least influence the formal development of the Administration's proposal. In addition to the "Big Six," I want to strongly recommend that the following persons be invited, in addition to myself – Dr. Samuel L. Myers, NAFEO; Dr. Laudeline Martinez, HACU; Dr. A. Dallas Martin, NASFAA; Dr. Arnold L. Mitchem, NCEOA; and Dr. Caspa Harris (NACUBO). You may want to include others.

I will be calling you within the next few days to discuss your reaction to my suggestions.

Sincerely,

Bill

William H. Gray, III

Enclosure

cc: Dr. Samuel L. Myers

STUDENT LOANS

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(202) 224-3244

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12 SOUTH SIXTH STREET
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United States Senate

DAVE DURENBERGER

February 26, 1993

Dear Colleague:

Tuesday, May 2, the Consumer Bankers Association has scheduled a "Lobby Day" on Capitol Hill -- to urge Senators and Representatives to oppose fundamental changes in federal student loan programs. In particular, CBA will be opposing plans to eliminate the role of banks, guarantee agencies, Sallie Mae, and other parts of the current loan system.

Because you may be contacted as part of the CBA "Lobby Day" we wanted to provide you with the attached background information. We have been part of a bi-partisan coalition of Senators and Representatives who support what CBA opposes -- a new program that's called "income-contingent direct loans."

Under such a program, loans flow directly to students from the federal government through higher education institutions. They are repaid based on post-college income through the IRS. A demonstration program to test the concept of direct lending was included in the Higher Education Amendments approved last year.

Income-contingent direct loans are also strongly supported by President Clinton as part of his proposal to make college affordable for every American. And, because it offers the potential for substantial budget savings, President Clinton included his own income-contingent direct loan proposal in the economic recovery package he unveiled last week.

Despite growing support all around the country for this type of program, banks and others who now profit from the current system are attempting to rally opposition. It is our hope that the attached information will be helpful to you next Tuesday and as this issue continues to be debated in the Congress and in your home states.

Finally, our bi-partisan group of Senators and Representatives is now working on an income-contingent direct loan proposal that we intend to introduce in the next several weeks. If you have questions about any of the enclosures, or are interested in co-sponsoring the bill, please call Bob Shireman at 4-5575.

Dave Durenberger

DAVE DURENBERGER
U.S. Senator

Paul Simon

PAUL SIMON
U.S. Senator

COMMITTEE ASSIGNMENTS:
FINANCE
ENVIRONMENT AND PUBLIC WORKS
LABOR AND HUMAN RESOURCES
SPECIAL COMMITTEE ON AGING

Shorter version will appear in March 1 Roll Call

What the Bankers Won't Say About Student Loans

By U.S. Senator
Paul Simon (D-Ill)

Bankers who profit under today's federal student loan program have declared war on President Clinton's plan to anchor the national service program to an improved student loan system involving direct loans with income-sensitive repayments through the IRS. They've proclaimed Tuesday (March 2) their "Lobbying Day" to defend their subsidies by trying to kill the direct loan plan.

To his great credit, President Clinton bucked heavy special interest lobbying in drafting his plan to transform the Guaranteed Student Loan (GSL) program and in including it in the economic package. It is based in part on changes that I proposed with Sen. Dave Durenberger in legislation we introduced last year. Our Senate allies have included Sens. Edward Kennedy, Bill Bradley and Daniel Akaka. Rep. Tom Petri has been pushing for these reforms for years, joined by allies like Rep. George Miller. All of these proposals save money by cutting banks and other middlemen out of the process, and instead offer federal loans directly to students through their colleges. Direct loans with income-based repayments are far better for students, schools and the taxpayers. But that's not what Members of Congress will hear this week from bankers and others who reap handsome profits from the GSL program.

The bankers will tout the GSL program as a "partnership" between government and business. What they will not say is that it is a partnership with the taxpayers taking all the risks, the colleges doing much of the work, and the lenders taking all of the profits. Streamlining the system with direct lending would reduce both the financial and paperwork burden on the current system.

But there is much more to the Clinton plan than direct lending. Shifting collections to IRS withholding will yield more savings by cutting defaults, which cost taxpayers nearly $3 billion last year. And by allowing payments to vary according to income, students won't be pressured into high-paying careers to handle their debt burden.

Banks have a small role in the current program

Banks have successfully delivered billions of dollars of loans to students, and for that, the nation should be grateful. But as the bankers begin their campaign on Capitol Hill, it is important for Members of Congress and their staffs to be aware of what the banks *don't* do:

- The banks do not carry out their normal role of deciding who can and can't get loans. (This is by design, to ensure that all eligible students have access to aid for college.)
- Most banks never see any students. Colleges provide the loan application, confirm students' eligibility for the program, and counsel borrowers about their repayment responsibilities.
- Most banks do not collect payments from students. Instead, while the student is in school, the bank bills the Education Department for interest payments quarterly. Then, when the student leaves school and the collection work begins, the bank sells the loan to a wholesale lender like the Student Loan Marketing Association (Sallie Mae).

Income-contingent repayment is not compatible with guaranteed loans

Sallie Mae and others are now suggesting that they can offer income-contingent repayment to borrowers without any need for direct lending or IRS involvement. There's reason to be skeptical of that claim, to say the least. First, the certainty of payment through the tax system is higher than any private entity can offer. Income-contingent repayment offered by a bank will not reduce defaults. Second, the task of confirming a borrower's income is bureaucratic and time-consuming for any collector who does not already have automatic access to that information.

In fact, for the past several years, the Education Department tested an income-contingent loan program that did not involve the IRS, and it was a bureaucratic nightmare. The magic of IRS collection is that it can automatically adjust to changes in income in a way that does not require additional work by the borrowers or employers. Income-contingent repayment is simply not compatible with the current guaranteed loan system.

Direct lending can save $1 billion a year

Three government reports, and cost estimates by the Congressional Budget Office and the Office of Management and Budget, all conclude that we save about a billion dollars a year by switching to a system of direct government lending. Last month, the bipartisan commission on student aid financing endorsed direct loans and income-sensitive repayments.

The first analysis of direct lending was conducted (and then squelched) by the previous administration's Education Department two years ago. It concluded that direct lending not only would save money but "would be easier to manage and would greatly reduce opportunities for error and abuse."

The U.S. General Accounting Office (GAO) followed up with a September 1991 study which concluded that a direct loan program could save more than $1 billion and
simplify paperwork for schools.

After some in Congress asked GAO to look more deeply at the Education Department's administrative costs, GAO produced a new study last November, finding that direct lending could save $4.8 billion over five years, similar to the previous estimate

CRS confirms bank profits

Bankers are anxious to put their own spin on a discussion paper released last week by the Congressional Research Service which posed several questions about some direct lending proposals. What they won't say is that the report essentially confirms that there is excess profit in the current student loan program.

They also won't mention that this discussion piece does not look at direct lending proposals that use IRS collection, and that the report points to income-contingent repayment as a potential solution to some of the problems of the current system.

And they certainly won't mention the report's two major recommendations for the current program: reduce the interest rate that is paid to banks, and cut some students out of the program. Both suggestions have real practical and policy problems – for students, for Congress, and for banks.

Students versus Banks

I certainly have nothing against banks. But a good public-private partnership reduces the risks and the costs that must be borne by the taxpayers. The guaranteed student loan system does not meet that test.

Students must be our top priority. President Clinton has proposed a plan for student loans that not only helps students, but aids taxpayers and the nation. He deserves credit for standing up to the special interests who would tear down his plan. In the interests of our students, our taxpayers and our economic vitality, Congress must not cave in to the special interests now, when real reform is at hand.

Senator Dave Durenberger

U.S. Senator for Minnesota

"Income-contingent direct loans: A good example of getting more for less"

by Sen. Dave Durenberger

One theme in early criticism of President Clinton's economic plan is that it doesn't do enough to cut government spending.

The President has promised to do more, but also challenged critics to tell him where more cuts could be made.

The difficulty in proposing spending cuts, of course, is that most programs have a good purpose -- and, almost certainly, a powerful constituency.

So, the toughest challenge in deficit reduction is to find ways of doing what good programs are designed to do -- for less.

One good example -- already in the President's economic package -- is a proposal that could accomplish two seemingly contradictory objectives: help make a college education more affordable for every American and save billions of dollars now being spent on federal student loan programs.

The proposal is for a new program of "income contingent direct loans." Such loans are designed to eliminate wasteful and complex overhead in current programs, and to offer all students the option of repaying what they borrow through the IRS as a percentage of post-college income.

This student loan proposal is based on legislation I introduced in the last Congress along with key allies like Sen. Paul Simon (D-IL) and Rep. Tom Petri (R-WI). A pilot program to test the same concept on a limited number of college campuses was included in last year's reauthorization of the federal Higher Education Act.

These proposals would all eliminate the current role of banks, secondary markets like Sallie Mae, collection agencies and other parts of the huge and profitable industry that has grown up around our federal student loan programs.

Instead -- at a projected savings of a billion dollars or more per year -- loans would flow directly to students from a federal trust fund with applications made through any eligible higher education institution.

Once students complete their education, they would begin repaying their loans only if their incomes were high enough to require federal income tax payments. Loan collection would be done through IRS withholding.

If student/borrowers are unemployed -- or underemployed -- loan payments will be lower, or even temporarily waived. Once student borrowers find better paying positions, loan payments will rise. But, if bad economic times again set in -- and the borrowers' incomes go down -- so will their loan payments.

This repayment flexibility also helps achieve one of the major goals of President Clinton's national service proposal -- by making it possible for student borrowers with large debt loads to spend a period of time in lower-paying community service jobs.

And, if universally available, this type of flexible loan program could have saved most of the $3 billion in defaults federal taxpayers had to subsidize last year.

So, an income contingent direct loan plan not only helps satisfy the access and national service commitments the new President made last year. It also saves money -- a "win-win" bargain that responds to the need to maximize the role that cuts in spending play in the economic recovery package that the President is now asking us to support.

Unfortunately, any fundamental change in existing student programs will run up against strong and well-entrenched special interests.

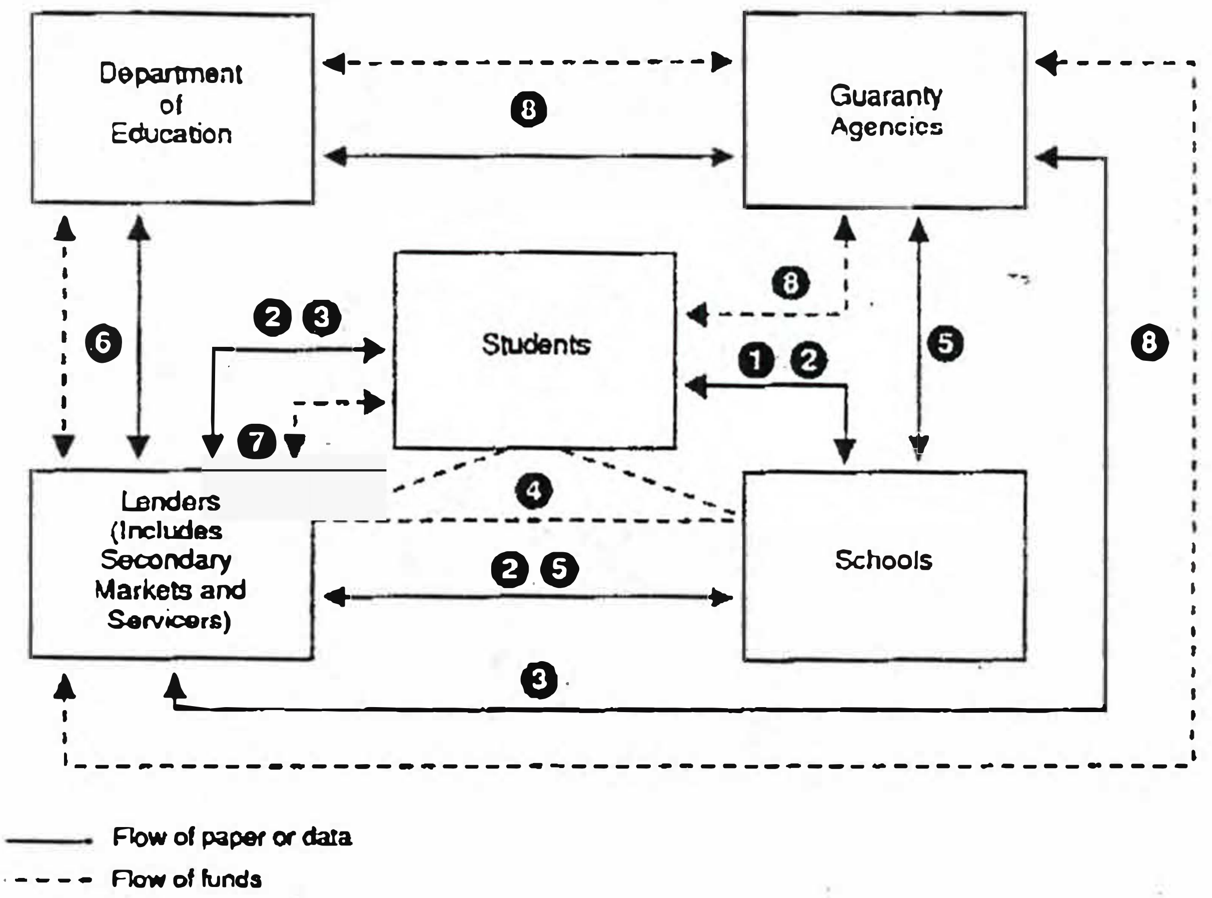
But, we must remember that the purpose of the federal student loan program is to help students and their families pay for college -- not to maintain six or seven figure salaries at Sallie Mae -- and not to protect an important profit center for banks.

Countering those special interests will require strong Presidential leadership.

But, if we continue to build support for the idea, income-contingent direct loans could help keep college affordable, and help bring down the federal deficit.

Dave Durenberger (R-Minnesota) is a member of the Senate Labor and Human Resources Committee and its Subcommittee on Education.

Figure 1: Federal Family Education Loan Program: A Complicated and Cumbersome Process



1. Student provides school with financial information and school determines loan eligibility and counsels student.
2. Student generally obtains loan application from lender, fills out his or her portion and forwards it to school; school completes application forwards it to lender.
3. Lender provides information to quaranty agency; agency verifies student eligibility and agrees to guarantee loan; lender sends promissory note to student; student returns signed note to lender.
4. Lender issues check to be endorsed by both school and student.
5. School periodically confirms borrower's continued student status.
6. Lender bills the Department of Education for interest subsidy, reports loan origination fees collected, and provides summary information on its guaranteed loan portfolio.
7. Lender bills student when repayment starts, collects payments, and conducts statutory loan collection services if borrower becomes delinquent or in default.
8. Guaranty agency reimburses lender for defaulted loans and receives reinsurance and an administrative cost allowance from the Department. The agency also receives an insurance premium from students. The agency pays the Department a loan reinsurance fee, shares collections on defaulted loans, and provides the Department with summary information of loans it guaranteed.

Jack Anderson and Michael Binstein

Banks That Bank on Student Loans

Student loans rank right up there with credit-card interest as a big money-maker for banks. The banks have gambled and lost on everything from speculative real estate to junk bonds, but with student loans there is no roll of the dice because the federal government guarantees the loans.

In order of profitability, student loans outpace auto loans, mortgage-backed securities, adjustable- and fixed-rate mortgages and U.S. Treasury securities. Only credit cards and commercial and industrial loans rank higher for profitability, according to the Education Department.

But it's another story for the taxpayers who pay when students default. In the past five years, defaults on federal student loans more than doubled. Last year, those defaults cost the taxpayers more than $3.6 billion.

One lobbyist for a major university told us that the system is "as much a lender-aid, or almost lender-welfare program as it is a student-aid program."

As early as next week, Congress may decide on reforms that would snatch this perk from the banks. A bill sponsored by Sens. Paul Simon (D-Ill.) and David Durenberger (R-Minn.) would establish a system of direct lending to college campuses, bypassing the banks. Collections would be handled by the Internal Revenue Service as part of withholding from paychecks after graduation. The sponsors say the money saved would be plowed back into more scholarships and grants.

Versions of the Simon-Durenberger plan are being considered in the House and the Senate and would save $1 billion a year by lending money directly to the students through the schools, according to the General Accounting Office. Collections would be handled by the IRS, but would be based on a sliding income scale so graduates whose education didn't buy them a high-paying job would not be forced to choose between paying their loans or eating.

The idea has the banking industry in a lather. Money lenders and other middlemen around the country have mounted what congressional sources say is a full-court press to stop any reform movement. They have won over the Bush administration, with the Education Department on record as opposing the idea.

Simon finds himself pitted against some old allies in the Senate too, including Sens. Edward Kennedy (D-Mass.) and Claiborne Pell (D-R.I.) who oppose the changes. But Simon also has found himself some new bedfellows among the Republicans who are urging the White House to back the plan. They believe that affordable education, like health care, is an issue that will win over the middle-class voters.

Beyond the big banks that do most of the volume lending, there are others with a stake in the status quo. The Student Loan Marketing Association, Sallie Mae, is a government-sponsored enterprise that makes a secondary market for student loans. There is also a raft of state-level guarantee agencies that are fighting for their own survival.

Even some universities that would benefit from reforming the system are torn. One university lobbyist told us, "Some schools say, 'We like this idea, but we have some bankers on our board and we really can't get behind it.' "

Sen. Simon wants to know, "Is this a program to help banks or a program to help students?"

Those who prefer things the way they are have wheeled out the big guns for the fight. Sallie Mae has hired the Washington public relations firm of Hill and Knowlton—a move that prompted some on Capitol Hill to ask why an institution created by Congress has taken on a life of its own and is hiring lawyers to lobby its creator.

In a hearing last year, Rep. Joseph Kennedy (D-Mass.) expressed concern about what he called a "schizophrenic notion" that these organizations work for the public while pushing private interests too.

For its part, Sallie Mae thinks this is no time to tinker with the system. In a position paper, Sallie Mae officials offered this protest: "Students and parents are too reliant on the flow of student loan dollars to justify gambling that an untested proposal will be a suitable replacement for a program that has provided $115 billion to 21 million borrowers over the past quarter century."

The way we see it, students and their parents are not the only ones who have become "too reliant on the flow of student loan dollars."

February 22, 1992

THE WASHINGTON POST

William Raspberry

Working Your Way Through College—After Graduation

Federally guaranteed student loans never quite seem to work out. They are too costly, or the default rate is too high, or income limits exclude too many prospective borrowers, or pseudo students take the low-cost money, drop out of school and buy the car they had in mind all along. As Gilda Radner used to say, "It's always something."

Well Sens. Paul Simon and David Durenberger have come up with a scheme they think could fix what ails student loans. Their IDEA—for Income Dependent Educational Assistance—is particularly timely, since Congress is considering a five-year reauthorization of the Higher Education Act.

In a nutshell, the proposal is for direct government loans (as opposed to bank loans *guaranteed* by the government), universal eligibility, and a pay-back schedule based on post-college income, with payments collected by the Internal Revenue Service.

The combination of simplicity and directness, its sponsors say, would save enough to make the scheme essentially revenue neutral.

But if it winds up costing more because it makes college available to more students, that's all right, too, they say.

"Under the present setup, we've had two kinds of losses—the loss of students and a huge default rate," Sen. Simon (D-Ill.) noted Thursday. "The cost of the loans has kept a number of young people out of college who otherwise would have attended, and the repayment schedule has led to a large number of defaults, particularly among students who wind up in low-paid jobs."

The plan he is cosponsoring with Durenberger (R-Minn.) would peg interest rates at two percentage points above the 12-month Treasury-bill rate, with a cap of 10 percent. Under the formula, the current interest rate would be about 7 percent.

The basics of the proposal have been around for a while. Then-secretary of education William Bennett came up with the idea of income contingency, but he included it in a too-modest pilot scheme—a five-year program involving 10 colleges and a limit of $17,500 per student.

Others have tinkered with the notion of broadening eligibility to include middle-class students but have worried lest some youngsters use the low-cost loans for non-college purposes—new cars, for instance.

The new proposal would avoid the new-car problem by having the loans go directly to the colleges. The maximum amount of the loan would be based on the particular college's cost-of-attendance formula. Universal eligibility would eliminate much of the administrative cost now involved in checking parental income and other financial resources. IRS collection, through payroll taxes, would minimize the opportunity for default, and the income-contingency feature would minimize the necessity for default.

Direct lending would save an estimated $1.4 billion a year, sponsors estimate, and IRS collection would save a hefty portion of the defaults, projected at $3.6 billion for this year alone.

Who could oppose a proposal to increase college attendance, ease the burden of repaying tuition loans and save money to boot? Some of the opposition is in the Senate itself—from members who would rather refine the existing legislation than try anything too radical. That opposition was being dissolved (or at any rate ameliorated) during negotiations late this week.

The other main opposition is from commercial lenders, who, thanks to the government guarantees, have made a nice profit on student loans. (On most private and commercial loans, bankers undertake the risk of default; the guaranteed student loans eliminate that risk.)

In addition, banks have counted student loans as part of their mandated goals under the Community Reinvestment Act.

The bankers' special pleading aside, there would almost certainly be unanticipated costs associated with the Durenberger-Simon scheme: start-up costs, collection costs and so on. But the benefits seem so obvious as to merit at least serious consideration.

At a time when we need more than ever to educate our young people, their parents are, more than ever, unable to send them to college. And the cost of college is so high that working one's way through (as many in my generation did) is scarcely a live option.

This proposal provides the means for young people (and not only the young) to work their way through college after the fact, and does so with enough safeguards to weed out the frivolous.

For my money, Paul Simon and David Durenberger have come up with a splendid IDEA.

WASHINGTON POST

WEDNESDAY, APRIL 29, 1992 A23

William J. Byron

Study Now, Pay Later: A Good Idea

The present system of federal financial assistance to college students needs creative modification. President Bush said as much to an Allentown, Pa., high school audience in mid-April. Bill Clinton says he sees his own idea in the Bush proposal to provide a "line of credit" up to $25,000 for any American who wants to use it for higher education. Meanwhile, members of the House and Senate conference committee on reauthorization of the Higher Education Act will soon sit down to hammer out their differences. How to handle student aid will be an issue.

Candidates offer few specifics. Legislators tend to amend past provisions to meet future needs. Now that the administration has come up with its "lifetime learning" proposal, the president could put his weight behind a demonstration project idea that will surely emerge in the Senate-House conference.

It is based on the "working your way through college" principle, only the sequence is reversed. College comes first, then "working your way through" by permitting the Internal Revenue Service to withhold a fixed percentage of the post-graduation paycheck until there has been repayment with interest of the federal funds advanced. Repayment would be income-contingent. This makes the obligation manageable, and, since repayments would be extracted from a gross income by IRS (a feature favored by the Senate but absent from the House-passed bill), this obligation moves to the front of the line ahead of other debt responsibilities.

This is what the public policy vocabulary calls a "direct lending" plan. With appropriate phase-in provisions, this approach could eventually, if the nation so wishes, replace guaranteed student loans (Stafford loans) and some other forms of federal student aid.

Resistance to this proposal comes from several quarters. College administrators are wary of excessive governmental intrusion. IRS involvement, even though it would be with the student and only peripherally with the institution, is resisted. IRS itself will not be anxious to take on additional work. The banks will resist. They like the GSL program, even though it costs Treasury between 35 and 60 cents on every commercial bank dollar loaned. The secondary marketers of GSLs want no change, nor do the various loan-servicing agencies, whose business would be reduced or eliminated.

Legislators who have labored to construct our present complicated system of federal student aid will be understandably reluctant to dismantle it, or even tinker with it, for an unproven alternative. But others are prepared to act, with vision and care, for change. Notable among them are Sens. Paul Simon (D-Ill.), Dave Durenberger (R-Minn.), Edward M. Kennedy (D-Mass.) and Bill Bradley (D-N.J.); and Reps. William D. Ford (D-Mich.), Tom Petri (R-Wis.) and Robert E. Andrews (D-N.J.).

When the Senate reauthorized the Higher Education Act in mid-February, a Simon-Durenberger-Kennedy-Bradley direct-lending provision was prepared but not offered. Instead, Kennedy, chairman of the committee responsible for Senate action on reauthorization, agreed to hold subsequent hearings and then send a direct-lending provision to Lloyd Bentsen (D-Tex.) for inclusion in the tax bill. The hearings were held; the amendment became part of the Senate-passed tax bill, which was later vetoed.

But direct-lending is still alive in the policy debate. House and Senate conferees on the higher education reauthorization bill may well approve a direct-lending demonstration project to begin perhaps as early as September 1993. I certainly hope so. I also hope the president will support such a project.

Policy architects could design a student financial assistance program that is characterized by universal eligibility, direct lending, income contingency, simplicity, workable terms and phase-in choices that would retain present programs as viable options. Any demonstration project would need to be large enough to produce a valid test of the merits of direct lending.

Institutions of higher education must not be scared off by those who raise the specter of government regulation and administrative complexity. The direct-lending idea is, as Norman Corwin said many years ago about brotherhood, "not so wild a dream as those who profit by postponing it pretend."

The writer is president of the Catholic University of America.

Guest Observer

By Sen. Paul Simon

Congress, Stand Firm for Clinton's Student Loan Plan

Bankers who profit under today's federal student loan program have declared war on President Clinton's plan to anchor the national service program to an improved student loan system that involves direct loans with income-sensitive repayments through the IRS.

The bankers have proclaimed Tuesday a "Lobbying Day" to defend their subsidies by trying to kill the direct loan plan.

To his great credit, President Clinton bucked heavy special-interest lobbying in drafting his plan to transform the Guaranteed Student Loan (GSL) program and including it in the economic package.

His plan saves money by cutting banks and other middlemen out of the process and instead offers federal loans directly to students through their colleges.

Direct loans with income-based repayments are far better for students, schools, and the taxpayers, but that's not what Members of Congress will hear this week from bankers and others in today's student loan industry who reap handsome profits from the GSL program. The bankers will tout the GSL program as a "partnership" between government and business.

What they will not say is that it is a partnership with the taxpayers taking all the risks, the colleges doing much of the work, and the lenders taking all of the profits. Streamlining the system with direct lending would reduce both the financial and paperwork burden on the current system.

We will save about $1 billion a year by switching to direct government lending from the current system, which lets banks and Sallie Mae reap profits as middlemen.

But there is much more to the Clinton plan than direct lending. Shifting collections to IRS withholding will yield more savings by cutting defaults, which cost taxpayers nearly $3 billion last year. And by allowing payment to vary according to income, students won't be pressured into high-paying careers to handle their debt burden.

Banks have successfully delivered billions of dollars of loans to students, and for that, the nation should be grateful. But as the bankers begin their campaign on Capitol Hill, it is important for Members of Congress and their staffs to be aware of what the banks don't do:

• The banks do not carry out their normal role of deciding who can and can't get loans. (This is by design to ensure that all eligible students have access to aid for college.)

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Students must be our top priority. President Clinton has proposed a plan for student loans that not only helps students but aids taxpayers and the nation. He deserves credit for standing up to the special interests who would tear down his plan. Congress must not cave in to the special interests [illegible] form is at hand.

Sen. Paul Simon (D-Ill) is a member of the Labor and Human Resources subcommittee on education, arts, and humanities.

Memorandum

To: Interested parties
From: Bob Shireman, education advisor to Senator Paul Simon
Date: February 24, 1993
Topic: **Overview of CRS report on direct student loans**

The CRS report referred to in today's *Washington Post* is "Federal Family Education Loans: Reduced Costs, Direct Lending, and National Income" (93-247 E). It is a theoretical economic discussion of direct lending (not of income-contingent repayment or IRS collection). Contrary to the Post headline, it does not focus on the national debt implications of direct lending.

The report essentially confirms that there is "excess profit" in the current system. It seems to conclude that if there was not excess profit (if rates were "competitive" rather than "more-than-competitive"), then direct lending would not save money. However, even on that point it's not exactly clear. It says that "Any increased funding available for public spending would be exactly offset by reduced private sector income." To me, that means that the government gets money instead of the banks.

The report suggests that there are other ways to reduce profit, such as reducing the special allowance (the interest rate return guaranteed to banks), without going to direct lending. This assumes that loans would be collected in the same way as they are now; under that model, the report points out that there is some risk that the Federal government would not be as efficient as the private sector in collecting. (Although it's important to remember that the Federal government would likely contract with the same firms that collect now, paying them a competitive rate rather than the politically-set subsidy). Again, any efficiencies that might be gained from IRS collection are not addressed by the CRS report.

Lowering the special allowance is risky

The report does not get into the *practical* problems with reducing the special allowance in order to save money. There is no way for the Federal government to know what the "optimal" rate is, and as we experiment to figure it out, there will be schools and students who are not served. This "temporary" problem could actually take quite a long time, and most schools (and politicians) are not willing to go through the pain. The students who would lose out would be those who are least profitable to the banks: students at community and state colleges with lower total borrowing.

Cut some students out of the program?

The report declares that "real economic gains could be made by targeting the program differently." The authors say that too many loans are made to students who do not benefit enough financially to pay off the loans. NOT making these loans in the first place would save the government default costs.

Again, the *practical* problem is figuring out which students are "failures" before they have failed. This runs counter to Congress's and the President's assertion that everyone should have the opportunity for a college education. CRS says making loans to "risky" students is only justified (in the parlance of economists) if there are "external benefits" to society, as opposed to increased earning potential for the individual borrower. For these students, CRS says that grants are better than loans (I can't argue with that)--or, if they do take loans, **income-contingent repayment** may be a better approach.

(CRS doesn't get into any details of income-contingent repayment. But experience from past experience suggests that it cannot be effective unless done by an entity that can easily confirm income--in other words, the IRS. In that case, the loans should be "direct," made by the Federal government. Otherwise, imagine the IRS trying to match borrowers' payments with the bank that originally made the loan. It would be a mess.)

Other Suggestions from CRS

CRS makes some other suggestions which, again, are far from clear in actual implementation:

- "More clearly establish" Sallie Mae's responsibilities to Federal taxpayers.
- Require schools to pay a portion of the costs of defaults by their students.
- Stop making loans to students who would have access to loans in the private sector.

Senator Simon's comments to the *Washington Post* about the CRS report:

"The report points to the benefits of income-sensitive repayments, a key component of the President's plan.

"It confirms that the student loan industry is taking excess profits while the government assumes virtually all of the risks. The question is how to reduce the costs while expanding access to college. Unfortunately, some of the CRS suggestions would lead in the opposite direction by cutting costs in ways that limit access."

"While portions of the report may be quoted out of context by special interests, within Congress it will contribute to a healthy discussion."

news from

PAUL SIMON

U.S. SENATOR ILLINOIS

Lawmakers Set Tuesday News Conference As Bankers Stage "Lobby Day" To Fight Shift to Direct Student Loans Under The National Service Program (In The Clinton Economic Package)

DIRECT STUDENT LOANS -- Tues., March 2, 11:30 a.m., Senate Radio and Television Gallery, S-325 Capitol. News conference by lawmakers supporting the direct student loan reforms in the National Service component of the Clinton Economic Package, in response to "Lobby Day" bankers have set for March 2 to try to derail the plan. Sen. Paul Simon, D-Ill.; Sen. Dave Durenberger, R-Minn.; Rep. Tom Petri, R-Wisc.; Rep. Rob Andrews, D-N.J. CONTACT: David Carle (Simon), 202-224-7115.

CBA Bank Alert

CONSUMER BANKERS ASSOCIATION
The Association for Retail Banks and Thrift Institutions

February 3, 1993

CBA PLANS MARCH 2 "LOBBY DAY" TO RALLY SUPPORT FOR GUARANTEED STUDENT LOAN PROGRAM

CBA, in conjunction with guarantee agencies and other participants in the Federal Family Education Loan Program (FFELP), is organizing a March 2 legislative workshop and lobbying day in Washington to challenge proposals for Direct Loans and the National Service Trust Fund. Additional information follows the status report on the Clinton Higher Education/Community Service proposals.

Throughout the 1992 Presidential campaign, Bill Clinton referenced four basic changes to [illegible] which collectively were referred to as the National Service Trust Fund prop[illegible]

PAUL SIMON
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COMMITTEES:
LABOR AND HUMAN RESOURCES
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United States Senate

WASHINGTON, DC 20510-1302

FROM: David Carle, press secretary, 202-224-7115

A rare opportunity comes March 2nd to catch a glimpse of members of a powerful special interest as they pad the halls of Congress trying to kill a key provision in the Economic Package that has pocketbook importance to every family needing help in sending a kid to college. Bankers have targeted March 2nd as their lobbying day to try to smother in the cradle the proposed direct student loan plan. During the transition, opponents like Sallie Mae went to great lengths to keep direct loans out of the package (including a nighttime visit to a key transition official at his home). Here's some background:

One of the biggest financial rewards of the Clinton economic package for working families -- and one that is still largely unnoticed and unreported -- is the President's decision to back Senator Simon's push for a new kind of federal loan to college students, and a simplified structure to implement it.

Clinton announced in his Feb. 17th address that he will anchor his national service plan to the key features of Simon's IDEA Credit student loan plan. Simon has worked behind the scenes for months to convince the President and his advisors to reach this decision and deserves great credit for steady and stunning progress in advancing this issue, against great initial odds and entrenched special interests. The President deserves great credit for bucking concerted lobbying by these same powerful interests and for deciding this on the basis of good public policy.

Another major victory for Simon's plan came weeks earlier when the bipartisan National Commission on Responsibilities in Financing Postsecondary Education endorsed IDEA Credit's key components -- direct loans, income-sensitive repayments, and IRS collection -- in its final report, issued Feb. 3.

Every family struggling with a college tuition -- and particularly middle-income families shut out of student aid programs during the 1980s -- will benefit under these changes, if Congress approves them. The phase-in from the Guaranteed Student Loan (GSL) program to Simon's plan -- which features

* universal (available to all),
* direct loans,
* for both first-time and lifelong learning students,
* with income-sensitive repayments,
* collected through IRS withholding,

-- would be the most significant reform of student aid policy in decades. In addition to the benefits to students and families, these changes yield massive savings at both the front end and the collection end of the student loan process, and they simplify the process and make it more accountable. These key concepts have been the big new idea in higher education for the last year, since introduction of Simon's Income-Dependent Education Assistance Credit (IDEA Credit) plan during the rewrite of the Higher Education Act. Sen. Dave Durenberger, R-Minn., is the leading Republican cosponsor of the Simon bill. Rep. Thomas Petri, R-Wisc., has been the stalwart advocate of these same ideas in the House, and Rep. Rob Andrews, D-N.J., is another ally. Last year, they pushed to include a $500 million (loan volume) pilot program to test IDEA Credit in the Higher Education Act, and it was enacted last summer.

Its leading opponents continue to be those who profit most under the today's Guaranteed Student Loan system, which has grown into an intricate maze that has become impossibly complex, costly and unaccountable. Sallie Mae, the government-chartered secondary marketer of student loans, has hired Washington's top "hired gun" lobbyists to kill the direct loan idea, and there will be more fights ahead.

Please call if you have questions.

Student Loans: The Wrong Cuts

With this vital program, Republicans appear to prefer a wasteful monopoly to effective competition

BY JONATHAN COHN

file
student
loan

Young people in this country are feeling the squeeze. Even as it's getting harder to get a decent job without a college degree, college itself is becoming prohibitively expensive for more and more people. From 1984 to 1993, median family income increased by 3 percent, while the average cost of tuition and fees at private colleges went up 91 percent. In real terms, the median family income keeps going down while tuition—at public as well as private schools—keeps shooting up.

The story gets even worse. As tuition explodes, federal and state education money is drying up and students are bearing a larger and larger share of the tuition burden. Reflecting the need for more aid, the federal student loan guarantee program saw loans grow 57 percent between 1992 and 1994. And these loans leave students with huge debts. Paying back \$50,000 at 8 percent over 10 years, for example, would mean a monthly payment of \$644. This makes it impossible for many graduates to go into low-paying lines of work like teaching, and it also discourages many from seeking a college education in the first place.

Meanwhile, a host of financial institutions have been making a mint off struggling students. Until recently, the federal government did not actually loan money to students directly; rather, it guaranteed private loans. The system proved expensive and wasteful. Private lenders made huge sums of money while doing little work and taking no risk. And service to students was decidedly not a priority.

In 1993, President Clinton decided to do something about it. Under his plan, which passed in Congress that summer, the government went beyond merely guaranteeing bank loans. Students were given the option of borrowing money directly from the Treasury. "Direct lending," as this program is called, quickly became wildly popular among students and schools, in part because the government streamlined the process to reduce paperwork. It has also saved taxpayer dollars by cutting out the middlemen.

The crucial element of direct lending, though, is the option of what's called income-contingent loans, which lets students pay off their debt as a

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percentage of their income, rather than set, monthly sums. Tying debt repayment to income was Clinton's original goal in reforming the student loan program: He wanted to encourage college graduates to take low-paying jobs in public service.

The benefits of direct lending, then, are connected both to government reform and to the broad social good. As a reform, it has injected competition into a student loan system once monopolized by lethargic private lenders. The social good is that by allowing flexibility for students repaying their debt - something that banks were unwilling to do—the government encourages post-graduate jobs in Teach for America and the Peace Corps, as opposed to just Wall Street and Madison Avenue. For these reasons, student loan reform is an all too rare success story in the federal government's recent history. "It's the best thing since microwaveable brownies," Colorado State University student Anthony Gallegos raved in *U.S. News & World Report.*

Sound like a good candidate for a round of bipartisan back-slapping? It would seem so, but despite direct lending's clear successes, Republicans in Congress are moving to limit sharply—or eliminate entirely—the program, which would also spell the end of pay-as-you-can loans. The financial institutions who were once making out like bandits have been lobbying hard to get back the business they've lost. And the GOP is inclined to give it to them, even though it's a bad deal for everyone else. Instead of doing more to fix the student loan program, Republicans seem intent on breaking it again.

Federal Loan Follies

Since 1966, the Federal Family Education Loan Program (FFELP) has helped more than 40 million Americans through college. But the program carrying out this admirable mission also developed a reputation as one of the federal government's most inefficient. The program cost billions to run—most of which went not to students but to quasi-governmental corporations that had learned to scam the system. For years, the loan program was denounced from both sides of the aisle as wasteful; it prompted a constant stream of investigations and warnings from the General Accounting Office. In 1991, for example, loans lost to default cost the federal government $3.6 billion.

The trouble was inherent in FFELP's basic design. Until Clinton's reforms, the government did not actually lend money to students, but rather coaxed banks to do so—by both guaranteeing loans and offering subsidies. Because the banks had very little incentive to get the money back once they'd loaned it—they'd get their money regardless, whether from the student or the government—"guaranty agencies" were created to police the banks. These guaranty agencies, state-chartered but privately owned, had three jobs. When a bank asked the government for reimbursement, claiming that a student had defaulted on the loan, the guaranty agency would: (1) find out if the bank had made a "good-faith" effort to collect; (2) if it had, pay the bank with money it was holding on behalf of the federal treasury; and (3) finally, pursue the loan itself, in a last ditch effort to save the federal government from swallowing the cost of the loan.

But there were serious problems with this plan. For one, guaranty agencies were literally guaranteed the contract by law, so they never had to bid for the work or worry that they'd get axed for poor performance. Worse still, the guaranty agencies actually had an incentive to do their job *poorly*. If they reported a lazy bank for failing to try to collect a loan, they got no reward. But if they ignored the banks, and went after all the loans themselves, they got to keep 27 percent of the money they recovered.

Not all guaranty agencies were corrupt, many did their jobs honestly and well. But there were enough bad apples—and enough other loopholes that allowed private companies to make a killing off the student loan program—that the federal government found itself wasting taxpayer dollars that were supposed to be helping young people go to college.

When he assumed office, Clinton pushed to reform this system, both to improve the program's efficiency and to give students the option of paying their loans back as a percentage of their income. Since the government was assuming the risk anyway—and since the maze of banks and guaranty agencies had proven to be a nightmare of waste and abuse—why not lend money directly from the federal Treasury? This would require the government to come up with the cash for loans. But there was potential for long-term savings, since taxpayers wouldn't have to pay interest subsidies to the banks or fork over a 27 percent cut to guaranty agencies. Clinton's idea was to have the IRS—which would have the necessary data on income—handle loan collections.

In a compromise with Congress, the bill the President signed implemented direct lending only partially. The Department of Education would have to compete with the private loan providers—banks and government-chartered groups like the Student Loan Marketing Association (Sallie Mae)—for much of the business. Direct lending would be capped at 5 percent of the total loans in the first year, but eventually anyone who wanted to could participate.

Blinded by the Right

Actually, the final bill was in many ways an improvement over what Clinton originally wanted. Setting up dual programs—both the Education Department (through direct lending) and private lenders (through the old system) would make loans to students—is a tried and true method of maintaining efficiency. Sure enough, when the government implemented a simplified application process and a speedier transfer of funds, private lenders followed suit. Forced to compete with direct lenders, Sallie Mae, which holds more student loans than any other lending agency, now offers all kinds of new repayment options for students. The same benefit was evident in the early years of the Tennessee Valley Authority, which acted as a yardstick to keep private utilities from gouging their customers.

The great disappointment of the battle over student loan reform was the loss of the IRS collection plan. As Steven Waldman recounts in *The Bill*, this idea died not due to corporate lobbying—which was fierce—but because of congressional turf battles. In the current political climate, there's little chance of reviving this idea. But it is a reform to keep pushing, since it would vastly simplify the process of tying loan payments to income.

So if these reforms were so smart, why do Republicans insist on rolling them back? Is it that they can't stand the idea of President Clinton—or activist government—doing something right? Or are they caving to private lenders, who prefer the old system of inefficient monopolies because they made more money that way?

The answer is "both." "It's pretty ridiculous to turn the Department of Education into some big lending institution, and the government has not exactly proved itself adept at this," says an aide to House Education and Opportunities Committee Chair William Goodling, clearly playing the anti-government card. "This is not something most Americans are comfortable with."

To make their point, Republicans cite figures that depict direct lending as vastly more expensive than the old system of banks and guaranty agencies. But their calculations are screwy. The Republicans changed the scoring rules for student loans, instructing the Congressional Budget Office (CBO) to count the administrative costs of the direct lending program—but not the guaranteed loan program. In other words, the CBO had to take into account all the costs associated with overseeing direct lending, while excluding, for example, \$160 million in annual subsidies to guaranty agencies that existed in the old program.

The Republicans' new accounting method by itself wouldn't be objectionable if the CBO applied it equally to both programs. But this way, the direct lending program is portrayed as much more expensive than the old guaranteed loan program. In fact, the original CBO estimate showed direct lending could save \$12 billion over five years. That estimate may have been inflated because CBO didn't account for administrative costs (the Republicans did have a point on that), but the existence of at least some savings is undeniable. Since direct lending eliminates all the subsidies to banks, guaranty agencies, and other intermediaries, it is bound to bring significant savings. "As long as it is necessary to provide a profit to induce lenders to guarantee student loans," Federal Reserve Board member Lawrence Lindsey wrote recently in a letter to

GOP Senator Spencer Abraham, "direct lending will be cheaper."

The best system would have direct lending and private banks compete, so that each could keep the other in line. The Republican solution, on the other hand, is to give the private-lending industry back its monopoly and then make it very difficult for the government to prevent abuse. Goodling's proposal would cut administrative funding for loan programs by two-thirds. Some of these cuts account for staff reduction in the direct lending program. But they would also force scalebacks in the Administration's ability to oversee the banks and guaranty agencies. Over seven years, those cuts could precipitate anywhere from \$1.5 billion to \$4 billion in new waste and fraud, according to reports by the GAO and the Education Department.

The best system would have direct lending and private banks compete, so that each could keep the other in line. The GOP prefers a monopoly.

The conspicuous beneficiaries of these changes would be the guaranty agencies and banks, both of which showed their strength in the 1993 student loan debate and came back with a vengeance this year. Republican proposals explicitly forbid the Education Department from cutting subsidies to the guaranty agencies. Republicans have also thwarted the Administration's effort to take back a \$1.8 billion fund that the guaranty agencies are sitting on--taxpayer money originally designated to repay banks for student loan defaults that the agencies now use to invest and make profit.

Less Competition, More Waste

Republicans claim to be seeking free market efficiency. But with student loans, they are moving toward a system with less competition and more waste. A provision in Goodling's bill would forbid the Education Department from advertising to students the option to transfer a private loan to the government, and thus get the benefits of paying back as a percentage of income. Lenders had complained they were losing business--25,000 loans have been switched over since 1993. But they were only losing business because students saw a better deal elsewhere.

If Gooding's bill passes, who will pay for these anti-reforms? Students, most likely. Although the government requires income-contingent payback options for all student loans, private lenders have shown great resistance in the absence of government competition, and enforcing the rule is difficult. The bottom line is that pay-as-you-can loans simply aren't feasible without direct lending. Private lenders don't want to do anything that might lose them money, and with the government removed as a competitor, they'll have no incentive to offer complicated payback plans. That means fewer graduates doing noble or necessary--but low-paying--work.

The other potential loss for college students is the cutbacks in subsidies that they now receive to ease the loan burden. Republicans have put the in-school interest subsidy—which pays interest on loans while students are in school, so they can complete their studies before having to worry about loans—on the blocks. Under Republican plans, the average student debt under the Stafford Loan program could increase by more than \$1,400 for a four-year undergraduate, and more than \$10,000 for a four-year graduate student, according to the Education Department. Again, it's not just that students will be left with big bills. Many will be scared off from college in the first place.

The Republican proposals on student loans are indicative of their ideological world view and the true nature of their political loyalties. GOP fondness for the "private sector" is defended on the grounds of efficiency and fairness: Citizens should receive the best services possible and bloated government bureaucracies often can't deliver. But, in this case, reducing government presence means worse service, and a worse deal for taxpayers as well.

With the student loan program, Republicans have an opportunity to prove that they are truly interested in fighting government waste and protecting the working class—just as they have always claimed. Instead, they are choosing to act as patrons for rich financiers, assuming no one will call them on it.

It's not too late to prove them wrong.