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Obama's Budget: Supporting Students, not Banks

By Eric Lotke, Christine Lindstrom and Armand Biroonak *March 26, 2009*

President Obama's budget proposal would transform the federal financial aid system that struggling students and families rely on to pay for college. The proposed budget cuts excessive lender subsidies, moves to more efficient direct lending instead, and invests the savings in students. The changes are major steps toward making college opportunity affordable for all Americans.

Passing the budget would reverse the misguided policies of recent years. Over the past decade, states have cut their contributions to college budgets and grant aid has stagnated. Students have been forced to pay ever higher tuitions and costs. At the same time, wages are flat and savings have plummeted. Facing skyrocketing costs, students and families have increasingly turned to loans to pay for college. The number of college students graduating with over $25,000 in student loan debt has tripled in the last decade.[1] The rising debt squeezes students and families out of higher education.

New data from the National Center for Education Statistics show prices rising:[2]

- In the U.S., the average cost of tuition at a public four-year college increased $1,729, or 29 percent, between 2000 and 2007.[3] Tuition went up 5 percent last year alone.[4]
- In Minnesota, the cost of tuition at a public four-year college has increased $2,862 or 37 percent.[5] Tuition went up 3 percent last year alone.[6] *(All figures adjusted for inflation).*

Among other changes, the Obama budget eliminates the Federal Family Education Loan Program that excessively subsidizes banks and moves to the US Department of Education's Direct Loan program. The Congressional Budget Office projects this move to save $47 billion over five years.[7] The Obama budget then redirects the savings to students. In 2010-2011, $5 billion would be cut from banks and lenders, and invested in students instead.

Redirecting the bank subsidies toward Pell Grants would solidify the grant program as the premier source of assistance for low income students. The Pell Grant maximum would increase from $5,350 to $5,550; the estimated national average Pell Grant award would increase by $121, from $3,236 to $3,357. Increasing the award will also bring in more students, estimated at 130,000 more students per $100 increase in the maximum award.

Pell Grant Increases under Obama Budget Proposal (est.)

	2009-2010 Avg. Pell Grant	2010-2011 Avg. Pell Grant, Obama Budget	Increased Avg. Pell Grant, Obama Budget	New Pell Recipients, Obama Budget
United States	$3,236	$3,357	$121	260,000
Minnesota	$3,052	$3,166	$114	3,862

Our Workforce and College Education

A robust economy keeps our communities vital and our nation strong. A well educated citizenry is essential if we are to compete as a high wage nation in a global economy. Ninety percent of the fastest growing job categories, 60 percent of all new jobs, and 40 percent of manufacturing jobs now require some form of post-secondary education.[8] At current rates of degree attainment, the U.S. is projected to fall 16 million college degrees short of meeting workforce needs in 2025.[9]

Our competitors among the industrial nations are outrunning us. According to the Organization for Economic Cooperation and Development (OECD), rates of college degree attainment are increasing in foreign countries faster than in the United States.[10]

College Costs Increasingly Out of Reach

However, the cost of college is increasingly out of reach for students and families. For too long, states have been reducing their share of the support for public colleges, and colleges raise tuition and fees to make up the difference. Just so far in 2009, at least 28 states have implemented cuts to public colleges and universities and/or levied large increases in college tuition to make up for insufficient state funding, with cuts proposed in four additional states.[11]

To offset the impact of rising costs, students and families of modest means have traditionally turned to need based grant aid. But grant aid has simply not kept pace with rising costs. The federal Pell Grant program, established in the early 1970s to make sure that no qualified student was turned away from college due to cost, now helps almost 7 million college students pay for college. But as college costs have risen, the purchasing power of the grant has diminished. Thirty years ago, the maximum Pell Grant funded 77 percent of the cost of attending the average four-year public school but today's maximum grant covers only 35 percent of the cost of attending a four year school.[12]

In 1977, a Pell Grant could cover 77% of public college costs.

Now it is down to 35%.

Student Debt and Negative Consequences

In reaction to budget cuts, rising costs and stagnant grant aid, student borrowing has risen dramatically. In the early nineties, less than one third of college graduates had loan debt. In 2004, close to 70% did, with an average of $19,000 in debt.[13] The number of students graduating with over $25,000 of student loan debt has tripled.[14]

This reliance on loans to pay for college has negative consequences. First, some students and families facing high costs will simply opt out. In 2008, the Advisory Committee on Student Financial Assistance estimated that between 1.7 and 3.2 million qualified students would skip college over the next decade because of the cost.[15]

Among those who make it to college but face staggering debt burdens, students opt to take on more paid work. Some work on top of studying can be helpful, of course, but too much is not. Students who work 25 or more hours per week have lower grades than those who don't.[16] Nearly half of all full-time working students are working enough hours to hurt their academic achievement and to distract from the forward-thinking that college is supposed to inspire.[17]

Upon graduation, student borrowers face daunting repayment. Such debt can cause graduates to delay buying a home, getting married, or starting a family. Twenty-three percent of people who graduate from four-year public college have too much debt to start a career as a school teacher; thirty-seven percent have too much debt to start as a social worker.[18] High debt can also lead to default, wage garnishment and ruined credit.

Steps in Making College Affordable

Congress responded to these problems after the 2006 election. The first step was passage of the College Cost Reduction and Access Act in 2007. It increased the Pell Grant to $5,400 in 2012, and created two new loan repayment programs to help borrowers. It was paid for by cutting $19 billion of excessive lender and bank subsidies from within the student loan program.

The next step came in February of 2009 with the American Recovery and Reinvestment Act, which pushes the maximum Pell Grant still higher. The act was passed as short term stimulus, however. Funding levels for the Pell drop off after 2012 and will remain unpredictable thereafter for struggling students and families. Congress is moving in the right direction after a decade of inaction, but American students and families still need more help.

Reinvesting in the Pell Grant

President Obama's budget makes a broader commitment. Among other key investments necessary to making college affordable, the proposal would make permanent the boost in Pell Grant funding in the economic recovery package, with a maximum grant of $5,550 for the 2010-2011 school year. In addition, the Pell Grant program is threatened by budget shortfalls every year, undermining the college financing plans of millions of students and families. The Obama budget turns the grant into a guarantee, insuring that the flow of Pell Grant aid is stable by increasing the grant at inflation plus one percent each year from 2011 on. Students would no longer need to wonder how next year's tuition and other educational costs will be paid for.

The proposal helps to pay for these changes by eliminating inefficiencies within the Stafford and PLUS student loan programs, freeing up more taxpayer dollars to go toward the proposed aid programs. For years, lenders and banks have received excessive subsidies to deliver student loans. In response to the uncertainty within the banking industry, Congress and the Department of Education further increased bank support, creating an emergency loan origination program for banks in the event that they lacked the capital necessary to give out federal loans to students. Decreasing private lender subsidies will save $47 billion to be reinvested in students instead.

FY 2010 Budget,
A New Era of Responsibility

"The President's budget asks the Congress to end the entitlements for financial institutions that lend to students…. [O]riginating all new loans in the direct lending programs, saves more than $4 billion a year that is reinvested in aid to students."[19]

Excessive Bank Subsidies for Student Loans

Banks and lenders have historically been involved in the federal student loan program. When the loan program began, students looked like poor financial risks. Young in age, with little credit history and few personal assets, students were not attractive candidates for private-sector lending – certainly not for the large sums needed to finance a college education.

The federal government helped solve the problem in 1966 by creating incentives for banks to lend. The Federal Family Education Loan Program (FFELP) guarantees lenders a higher interest rate than the base market rate, ensuring a healthy profit on monies loaned. On top of that, *the government guarantees payment of principle and interest in case of default.*[20] For the banks, it was a win-win proposition: higher interest rates with no real risk. The Student Loan Marketing Association (Sallie Mae) was created to manage the money, and the program was crucial to making college accessible for millions of Americans.

Over time, the market matured. Well-educated, high-earning college graduates proved to be excellent credit risks, and student lending has grown into a highly profitable industry. Dozens of new banks and lending institutions have entered the field. Sallie Mae itself has privatized into SLM Corporation, whose stock can be bought and sold on the New York Stock Exchange.

In the 1990's, the need to continue bank subsidies was called into doubt. The Department of Education created a Federal Direct Loan (FDL) program in 1993 to lend money to students at low rates available only to the U.S. Treasury. Such loans reduced payments for students and did not increase the government's risk because the old system already used the government to guarantee defaults.

Experience showed that direct lending works. The administrative costs are lower, the design is simpler and it eliminates subsidies to the private loan industry. A report by the Government Accountability Office in 2005 found that the Direct Loan program costs the federal government $1.70 for every $100 of loans, compared to $9.20 per $100 of loans through the FFEL program, with bank intermediaries.[21] In other words, $7.50 was saved for every $100 loaned. Thus, the direct loan program wasn't just better for students; it was better for taxpayers too.

Meanwhile Sallie Mae and other lenders became a political force, giving out more than $583,000 to lawmakers and political action committees focused on education in 2008.[22] They mounted a significant effort to defeat the College Cost Reduction and Access Act in 2007, and they have worked to strip basic consumer protections for student borrowers. Student loans are the only type of consumer loan for which borrowers cannot seek bankruptcy.

In 2008, the sour economy forced Congress and the Department of Education to further subsidize banks, offering capital in the event that they cannot originate federal loans for students. While more and more taxpayer money is siphoned out of the loan programs to keep the banks and lenders involved, students and families face higher costs and deeper debt. The Obama budget proposal would cut the excessive subsidies required to keep banks and lenders involved in the student loan process and apply those savings to student aid instead. This bold move is the type of reinvestment that American families and students need to get into college and get the education needed to lead our country forward.

APPENDIX 1

Public Four-Year College Tuition. National Center for Education Statistics.[23]

	Tuition 2007-08	Percent Change 2000-01 to 2007-08	Percent Change 2006-07 to 2007-08
United States	**$5,950**	**29%**	**5%**
Alabama	$4,907	27%	4%
Alaska	$4,747	26%	7%
Arizona	$4,954	43%	6%
Arkansas	$5,427	33%	9%
California	$4,879	37%	9%
Colorado	$5,250	32%	12%
Connecticut	$7,465	27%	4%
Delaware	$7,823	26%	5%
Florida	$2,980	4%	-1%
Georgia	$4,006	19%	6%
Hawaii	$4,653	23%	16%
Idaho	$4,381	28%	5%
Illinois	$8,982	44%	10%
Indiana	$6,604	31%	5%
Iowa	$6,219	39%	3%
Kansas	$5,406	41%	8%
Kentucky	$6,342	45%	8%
Louisiana	$3,835	13%	2%
Maine	$7,250	29%	9%
Maryland	$7,141	19%	1%
Massachusetts	$7,922	39%	4%
Michigan	$8,471	34%	11%
Minnesota	$7,707	37%	3%
Mississippi	$4,762	25%	6%
Missouri	$6,643	30%	5%
Montana	$5,418	32%	1%
Nebraska	$5,443	31%	5%
Nevada	$3,053	7%	7%
New Hampshire	$9,610	19%	6%
New Jersey	$9,702	30%	4%
New Mexico	$4,143	24%	5%
New York	$5,065	3%	1%
North Carolina	$4,301	36%	6%
North Dakota	$5,765	39%	5%
Ohio	$8,090	29%	-11%
Oklahoma	$4,471	39%	7%
Oregon	$5,939	26%	6%
Pennsylvania	$9,593	26%	5%
Rhode Island	$7,120	24%	6%
South Carolina	$8,389	33%	6%
South Dakota	$5,395	22%	6%
Tennessee	$5,366	34%	7%
Texas	$5,538	39%	8%
Utah	$4,046	33%	6%
Vermont	$10,401	17%	6%
Virginia	$6,887	35%	6%
Washington	$5,353	19%	-4%
West Virginia	$4,377	30%	6%
Wisconsin	$6,177	33%	2%
Wyoming	$2,990	-4%	1%

APPENDIX 2

Pell Grant Changes under Obama Budget Proposal (est.)

	Pell Grant Recipients	Pell Grant Award Total	2009-2010 Avg. Pell Grant	2010-2011 Avg. Pell Grant, Obama Budget	2010-2011 Increased Avg. Pell Grant, Obama Budget	Total Cost, Obama Budget	New Pell Recipients, Obama Budget
U.S. Total	**5,152,828**	**$12,784,876,297**	**$3,236**	**$3,357**	**$121**	**$5,718,684,000**	**260,000**
ALABAMA	92,795	$239,783,273	$3,413	$3,541	$128	$93,777,000	4,682
ALASKA	4,736	$10,797,310	$3,012	$3,124	$113	$4,223,000	239
ARIZONA	220,844	$515,336,298	$3,083	$3,198	$115	$201,541,000	11,143
ARKANSAS	55,676	$144,948,342	$3,439	$3,568	$129	$56,687,000	2,809
CALIFORNIA	545,935	$1,406,693,200	$3,404	$3,531	$127	$550,140,000	27,547
COLORADO	80,148	$184,288,858	$3,037	$3,151	$114	$72,073,000	4,044
CONN.	38,554	$87,108,856	$2,985	$3,096	$112	$34,067,000	1,945
DELAWARE	8,929	$20,388,832	$3,016	$3,129	$113	$7,974,000	451
WASH. D.C.	19,910	$47,309,758	$3,139	$3,256	$117	$18,502,000	1,005
FLORIDA	284,785	$680,859,753	$3,158	$3,276	$118	$266,275,000	14,370
GEORGIA	172,860	$379,644,355	$2,901	$3,010	$108	$148,474,000	8,722
HAWAII	10,320	$26,558,666	$3,400	$3,527	$127	$10,387,000	521
IDAHO	28,765	$74,763,326	$3,433	$3,562	$128	$29,239,000	1,451
ILLINOIS	201,468	$479,004,572	$3,141	$3,258	$117	$187,332,000	10,166
INDIANA	108,148	$254,597,930	$3,110	$3,226	$116	$9,957,000	5,457
IOWA	83,423	$193,359,099	$3,062	$3,176	$114	$75,620,000	4,209
KANSAS	48,268	$116,300,051	$3,183	$3,302	$119	$45,483,000	2,435
KENTUCKY	80,605	$204,013,234	$3,343	$3,468	$125	$79,787,000	4,067
LOUISIANA	81,433	$217,686,257	$3,531	$3,663	$132	$85,134,000	4,109
MAINE	18,899	$46,773,023	$3,269	$3,392	$122	$18,292,000	954
MARYLAND	66,173	$154,604,137	$3,086	$3,202	$115	$60,464,000	3,339
MASS.	76,528	$185,284,278	$3,198	$3,318	$120	$72,462,000	3,861
MICHIGAN	181,767	$419,493,250	$3,049	$3,163	$114	$164,058,000	9,172
MINNESOTA	76,537	$176,849,778	$3,052	$3,166	$114	$69,164,000	3,862
MISSISSIPPI	71,798	$199,832,654	$3,677	$3,814	$137	$78,152,000	3,623
MISSOURI	102,770	$248,521,639	$3,194	$3,314	$119	$97,194,000	5,186
MONTANA	15,370	$40,188,755	$3,454	$3,583	$129	$15,717,000	776
NEBRASKA	26,254	$59,834,209	$3,011	$3,123	$113	$23,400,000	1,325
NEVADA	15,423	$35,684,669	$3,056	$3,171	$114	$13,956,000	778
NEW HAMP.	12,675	$29,296,033	$3,053	$3,167	$114	$11,457,000	640
NEW JER.	101,159	$256,271,097	$3,347	$3,472	$125	$100,224,000	5,104
NEW MEX.	38,631	$96,002,155	$3,283	$3,406	$123	$37,545,000	1,949
NEW YORK	359,064	$955,247,913	$3,514	$3,646	$131	$373,585,000	18,118
N. CAR.	140,673	$359,688,011	$3,378	$3,504	$126	$140,670,000	7,098
N. DAKOTA	12,438	$31,201,132	$3,314	$3,438	$124	$12,202,000	628
OHIO	198,043	$473,471,427	$3,158	$3,276	$118	$185,169,000	9,993
OKLAHOMA	68,845	$172,695,572	$3,314	$3,438	$124	$67,539,000	3,474
OREGON	58,280	$142,405,648	$3,228	$3,348	$121	$55,693,000	2,941
PENN.	184,817	$450,763,735	$3,222	$3,342	$120	$176,288,000	9,325
P. RICO	200,604	$601,483,919	$3,961	$4,109	$148	$235,233,000	10,122

RHODE ISL.	20,924	$49,698,596	$3,138	$3,255	$117	$19,436,000	1,056
S. CAR.	72,292	$178,170,462	$3,256	$3,377	$122	$69,680,000	3,648
S. DAKOTA	16,240	$38,875,965	$3,162	$3,280	$118	$15,204,000	819
TENNESSEE	103,543	$256,915,820	$3,278	$3,400	$123	$100,476,000	5,225
TEXAS	397,738	$999,213,292	$3,319	$3,443	$124	$390,779,000	20,069
UTAH	56,619	$134,973,380	$3,149	$3,267	$118	$52,786,000	2,857
VERMONT	8,383	$19,986,838	$3,150	$3,267	$118	$7,817,000	423
VIRGINIA	94,278	$229,644,622	$3,218	$3,338	$120	$898,110,000	4,757
WASH.	77,932	$188,103,504	$3,188	$3,308	$119	$73,565,000	3,932
W. VIRGINIA	35,317	$93,002,299	$3,479	$3,609	$130	$36,372,000	1,782
WISCONSIN	67,874	$159,326,441	$3,101	$3,217	$116	$62,311,000	3,425
WYOMING	7,338	$17,930,074	$3,228	$3,348	$121	$7,012,000	370

Data Sources and Notes

- State-by-state Pell Grant recipients are derived from the Department of Education, Pell Grant End-of-Year Report, 2006-2007.[24] We applied the state-by-state pro-rated share of students in 2006 to the more recent national 2007 data to update state-by-state recipients.[25]

- The averages were tabulated by dividing the number of award recipients by the amount of aid awarded in 2006-2007, to generate an average aid award. We then calculated what percentage of the maximum grant each state was getting on average in 2006. Using the same percentage, we calculated the average aid awards for 2009-2010 and 2010-2011 using the Pell Grant maximums of $5,350 and $5,550 respectively.

- Figures are rounded to the nearest 1,000 and based on the Congressional Budget Office's estimate that $5 billion will be spent to boost the Pell Grant in 2010-2011. Using the figures in the "Total Pell Grant Amount" column, we determined the state-by-state percentage of grant aid from the national total. We applied these percentages to the $5 billion figure to generate a state-by-state approximation of increased aid under the Obama proposal.

- Financial aid expert Mark Kantrowitz, analyst and founder of www.finaid.org, estimates that for every $100 increase in grant aid, 130,000 new recipients are added.[26] He stated: "Pell Grant eligibility is pegged to a range of EFC (Expected Family Contribution) scores from 0 to 95% of the maximum Pell Grant. So the question boils down to the distribution of EFC scores. I used the 2003-04 NPSAS DAS to measure distributions as well as looking at how the number of recipients has changed over the years with increases in the maximum grant normalized by changes in the EFC formula. This yielded a 130,000 rule of thumb. The distribution isn't flat, but is more of a bell curve, but 130,000 is a reasonable approximation." Since the Pell Grant max increases by $200 from 2009-2010 to 2010-2011 under the president's proposal, approximately 260,000 new students will be added. We estimated the state-by-state increase by using the percentages generated from the 2006-2007 recipient data.

ENDNOTES

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