

What State Policymakers Should Know About Federal Higher Education Policy

Despite the mantra that education is primarily the states' responsibility, the federal government is an important and influential player when it comes to providing higher education to the nation's students. The federal government invests roughly \$25 billion annually in higher education excluding loans that are ultimately repaid, military benefits that are earned, and tax credits. State policymakers need to understand the nature of this federal investment and the rationale behind it if they are to gain the maximum advantage from their state investments. Then, they can begin to harmonize state and federal policies so that they complement each other to the extent that this is possible and to design state policies in ways that maximize the take-up of federal dollars in the state, both to benefit students and to relieve state fiscal pressures.

All of us who work in state-level policymaking in one fashion or another know our mantra: education is primarily the states' responsibility, not the federal government's. And that is certainly true on the supply side of the economics of higher education in the U.S. States and localities have paid for and developed public colleges and universities that today enroll more than 75 percent of college students. This bricks-and-mortar investment has reaped huge dividends for our country. Although private philanthropy and gifts have funded (and named) many facilities within public colleges and universities, and federal funds have aided construction of many research facilities, the bulk of the costs associated with building and maintaining the public infrastructure has fallen to the states. In addition, each year states and localities provide about \$70 billion in operating funds for their public institutions to continue to provide high-quality education.

The federal investment in higher education isn't, however, chicken feed. While it is a bit disingenuous to claim, as the federal government often does, that it provides \$90 billion annually (considering that more than \$60 billion of that amount is actually in loans that will ultimately be repaid, another \$3 billion are military benefits that have been earned, and \$8 billion are tax credits), nonetheless, the roughly \$25 billion that the federal government budgets each year for student assistance, institutional support, and research reflects a substantial commitment.

State policymakers need to understand the nature of this federal investment and the rationale behind it if they are to gain the maximum advantage from their state investments. First, it is important to harmonize state and federal policies so that they complement each other to the extent that this is possible. Second, it is important

to design state policies in ways that maximize the take-up of federal dollars in the state, both to benefit students and to relieve state fiscal pressures.

The Higher Education Act

The official federal role in American higher education is ostensibly set out in the Higher Education Act (HEA) of 1965, as amended. The HEA lays out the federal government's intent to support students through financial aid, enhance struggling institutions that serve unique federal purposes, improve teacher education programs, support international and graduate education programs that serve unique federal needs, and fund myriad other programs that serve the special interests of federal policymakers. The original act with 52 pages of text in 1965, has grown to 700. The act's most recent amendments, adopted in 1998, ran to more than 400 pages.

The status of the HEA is currently in flux because of a very unusual set of circumstances. The HEA was to have been reauthorized in fiscal year 2004. That was an election year, however, and other Congressional concerns took precedence. So the act, as amended in 1998, was automatically extended for a year. But it proved impossible to complete reauthorization in 2005, as well. Thus began a process of temporary extensions that continue to the present time. Portions of the act were reauthorized recently within the Budget Reconciliation Act, but most of it was not.

This unusual set of circumstances evolved from the confluence of three major forces within Congress. First, the strong partisanship that has characterized the most recent sessions of Congress – between

political parties within and between each chamber of Congress – have made it difficult to reach consensus on the future role of the federal government in higher education. Second, the tough budget decisions facing Congress, resulting from recent tax cuts and increased defense spending, have made it difficult to pass new legislation, particularly legislation that could increase the cost of federal domestic programs, because new resources are simply not available for programs not related to defense. Third, changes in the legislative leadership of key education committees in the House have slowed the reauthorization's progress.

Although reauthorization is not yet complete, it is reasonably clear what the final result will be. When finally finished, there will be several incremental changes to the existing act but no major new directions in federal policy.

- Authorization levels for some programs, such as the Pell Grant Program, will be increased, but those levels will never be realized. This is nothing new or startling, however: authorized levels have not been realized since the 1970s.

- There will be more mandates for states and institutions via enhanced monitoring, oversight, and regulation. In contrast to funding levels, these new, unfunded mandates will be realized.

- There will be a new definition of what constitutes “an institution of higher education,” which will include all degree-granting, for-profit institutions that were previously termed “postsecondary institutions.” While this may not on the surface seem significant because these institutions have always been eligible for federal student assistance, this change will, in fact, be very important. First, it will make these institutions eligible, for the first

time, for other forms of federal grant aid, such as research funds and institutional aid from federal departments that rely on the Department of Education to define what constitutes a higher education institution. Second, in states that also rely on the federal definition, these institutions will be eligible for state financial aid.

All in all, however, not much will change. The subsidy structure of federal student aid will remain much more regressive than the original HEA envisioned, with students from well-to-do families receiving substantial federal subsidies through both student loan programs and tax-credits while the most financially distressed students receive an increasingly smaller share of overall resources.

Federal Appropriations

While folks generally think of authorizing law as the guiding light of public policy, at the federal level, *appropriations law* largely shapes the federal role in higher

education. While the HEA and federal funding are roughly in sync, that was not always so.

One dilemma at the federal level is the unusual disconnect between funding what are known as *mandatory entitlement* programs versus funding what are called *discretionary nonentitlement* programs. Within the HEA, all programs except the major student loan programs are considered discretionary, while student loans are considered mandatory entitlements. That means that all programs except loans are constrained by the availability of federal funding for domestic programs. Loans, however, must be appropriated at whatever level of funding is necessary to meet their authorized costs, and students are considered entitled to loans for whatever amount they are eligible. Not surprisingly, the amount being borrowed via the federal student loan programs has been increasing rapidly in recent years, since such borrowing is virtually uncontrollable. The amounts of student grant aid provided via Pell Grants and institutional aid, on the other hand, have been constrained because tax cuts and defense spending have greatly reduced the funds available for discretionary nonentitlement programs.

Confusing this story, however, is the way the Pell Grant program works. The Pell Grant program actually operates as a quasi-entitlement endeavor. Every eligible student receives a Pell Grant; the constraint comes in the amount that they will receive. Recent fiscal constraints have resulted in a freezing of the maximum Pell Grant at \$4,050 for the last five years.

Much rhetoric in higher education recently suggests that the federal government has “lost its way,” shifting funds from grants to loans. But this perception is incorrect.

Federal funding for grants has not actually declined. It is true that Pell Grants today cover a much smaller share of the college costs than they used to, and certainly over the past five years freezing

the maximum Pell Grant at \$4,050 has reduced the purchasing power of these grants. But the actual federal appropriation for the program has never been higher. For fiscal year 2006, Congress appropriated \$13.5 billion to the Pell Grant program, 25 percent more than its funding level just six years ago, when President Bush took office.

How can this be possible, given that the Pell Grant maximum has been frozen for five years? It is possible because far more students are eligible for Pell Grants today than was the case five years ago – and more qualified students require more dollars. It is also true that student loans and the federal costs associated with subsidizing these loans now represent a much larger share of the federal overall commitment to higher education. This is not because of a shift from grants to

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loans, however, but simply because of a burgeoning demand for student loans, driven in great part because of the entitlement nature of the program and also because of a subsidy structure that encourages students to borrow, whether they need to or not. When a student can secure a federally subsidized loan that bears no interest while in school and accrues extremely low interest once out of school, it is clearly in the student's best economic interest to take advantage of such a loan.

The Partnership

Whether they realize it or not, the states and the federal government are partners in this endeavor. Because federal student aid is generally the first dollar in, states actually have great leverage in this partnership. Yet many states foolishly ignore its value. Community colleges in California, for example, charge virtually no tuition and thus greatly underutilize available federal student assistance, ignoring resources that could be garnered without increasing the net price to most students.

State policymakers also need to understand that tying their assessment of student financial need to the "federal methodology" for determining need, as most states do, ties them to an antiquated, irrational system that is driven more by politics and budget constraints than by any true analysis of what students actually need to attend college. This is not a big deal for the federal government because their grant aid is well targeted to very low-income students; in addition, federal policymakers actually enjoy the liberal interpretation of need at higher income levels because it makes most middle- and upper-middle-income students eligible for federally subsidized student loans (which appeases middle-income voters). Most states, however, follow in lock step, without ever making the intentional policy choice about whether the students they wish to assist are the same as those that the federal government seeks to assist.

A final important feature of the federal appropriations process, from a state policy perspective, is that most federal education programs are "forward funded," which means that the funds appropriated in one year are not available for spending until the following year. For example, the funds appropriated in the federal fiscal year 2006 budget cannot be obligated for spending until October 1, 2007, the beginning of fiscal year 2008. The rationale for this forward-funding concept is that higher education institutions need some time to plan for changes in law and funding levels and that this delay provides the necessary planning time. One dilemma with this concept, however, is that it is hard to make funding changes that immediately impact higher education because changes are always delayed at least one year.

Federal Tax Benefits for Higher Education

The third area of federal policy that state policymakers need to understand in order to make informed judgments about the interface of federal and state policies is the area of federal tax benefits that assist higher education. Tax benefits have long helped both public and private higher education through a variety of provisions, such as tax-exemption for public and nonprofit organizations, tax benefits for businesses that pay educational expenses for employees, research and development tax credits that encourage industries to support university research, tax deductions for children who remain dependent on their parents while attending college, and tax benefits for college savings. Having been around for a long time, for all practical purposes, these benefits are imbedded in both federal and state tax and appropriations policies.

More recently, however, two significant federal tax benefits – the HOPE Scholarship and Lifetime Learning tax credits – have become available, and many states have not yet fully incorporated them into their state policy framework. Adopted in 1997 and first available to families paying taxes in 1999, these programs currently provide more than \$8 billion in tax relief to students and their parents each year. Through the HOPE Scholarship program, a family with income below \$100,000 may claim a tax credit up to \$1,500 for each child attending college at least half time for the first two years of college attendance (100 percent of the first \$1,000 and 50 percent of the second \$1,000 of tuition paid). The Lifetime Learning Credit provides up to \$2,000 annually for students (20 percent of up to \$10,000 of tuition paid).

In many states current policy obviates the value of these new resources, both to the states' citizens and to the states themselves. In California, for example, where community college annual tuition is currently less than \$700, tuition could be raised by \$300 without raising the net cost to any students from tax-paying families. Yes, the families would pay an additional \$300 out of pocket, but their tax liability would be reduced by an equal amount, leaving them paying no more for college but providing the college with an additional \$300 per student in support. States or institutions that provide tuition waivers also leave these federal benefits on the table; if you do not pay tuition (because you receive a tuition waiver), you are not eligible for the tuition tax credit. It's as simple as that.

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Clearly, the interface of federal tax benefits with state policy is an area that is increasingly worthy of intentional state review and consideration.

Focus on Accountability

For the past 15 years, the federal government has become increasingly concerned about higher education accountability issues. The first major federal foray came during the 1992 HEA reauthorization. Driven by increasing student loan default rates and an enlightening and damning investigation by the General Accounting Office (since renamed the Government Accountability Office) into fraud and abuse in federal student aid programs, both the administration and Congress supported strong legislation to enhance accountability for institutions participating in federal programs.

Much of this effort focused on reforming the previously fashioned partnership between the federal government, states, and accrediting organizations in order to assure quality. This partnership, known as “the triad” was considered to be ineffectual; many believed that the federal programs were mismanaged, accreditors were lax, and states were a mixed bag in terms of quality. To address this, the role of all three partners was enhanced. But the most significant change was a substantially greater reliance on the states, through new agencies known as the state postsecondary review entities (SPREs). Developed with federal funding, SPREs were to provide greater state oversight of finances, academic integrity, efficacy in terms of graduation rates, and consumer protection.

This federal reliance on state-based accountability enhancement did not long survive, however. The higher education community fought the concept of greater oversight, and many of the states felt uncomfortable in their new role.

Yet the concern about higher education accountability did not diminish with the demise of the SPREs. In 1996, Congress commissioned a National Commission on the Cost of Higher Education, charging it with a dual mission: to discern whether federal policies were fueling the exceptional increases in tuition and other costs and to figure out whether federal policies could effectively curb the forces contributing to these escalating prices.

In 2005, the National Commission on Accountability in Higher Education, convened by the State Higher

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Education Executive Officers (SHEEO), released its report *Accountability for Better Results*. This report condemns state and federal governments for “a failure to develop and implement accountability approaches that help improve performance.” It sets out a robust scheme for identifying the

discrete but complementary roles of the states, federal government, institutional trustees and leaders, accrediting associations, and faculty and students

in assuring stronger, relevant, more contemporary, accountability.

Also in 2005, Secretary of Education Margaret Spellings convened a National Commission on the Future of Higher

Education. Its final report, to be released imminently, includes a substantial focus on enhancing accountability, particularly with regards to addressing equity gaps

within higher education and the absence of sound ways for accounting for student learning outcomes.

Concluding Comments

For a variety of reasons, therefore, it makes sense for state policymakers to keep abreast of federal policy.

- The federal role in student aid, institutional improvement, and research and development, as reflected in authorized federal law, is so significant that it creates a de facto partnership with the states, whether the federal government recognizes this partnership or not.
- Federal funding of student aid and research and development is so pervasive that it drives much of the direction in these two arenas, and states must recognize both the opportunities and dilemmas this provides.
- Federal tax law is becoming an increasingly prevalent policy tool, which can significantly affect the efficacy of current state policies and programs, even perhaps suggesting substantial changes to be “policy smart” at the state level.
- And finally, current discussions of accountability by the federal government and other national entities will almost certainly force changes in state policy.

So pay attention to this federal stuff. It’s mighty important to your state efforts in higher education – even if higher education is a state responsibility.

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