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THE WHITE HOUSE
WASHINGTON

To Bill Galston

FYI –

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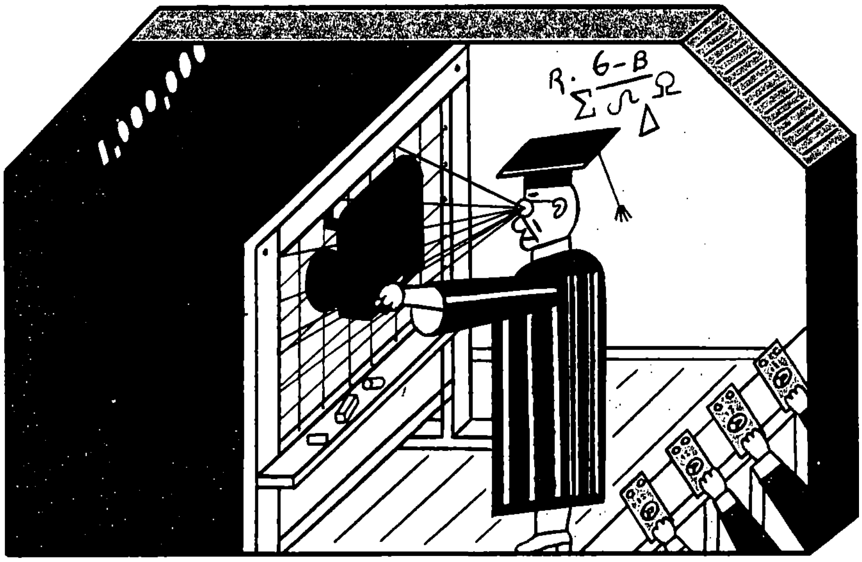


EDUCATION

Why College Tuitions Are So High

Not inflation, not enrollment decline, but the subsidization of corporate research is largely to blame

OVER THE PAST two years numerous articles have appeared in the national press about the "fiscal agony" that American colleges and universities are experiencing. A front-page article in *The New York Times* in February of last year announced, "BAD TIMES FORCE UNIVERSITIES TO RETHINK WHAT THEY ARE." Two months later *Time* magazine ran a cover story warning that administrators are facing a "cost crunch that, recession or no, promises only to grow worse." Other articles have addressed how this crisis affects students. *The Miami Herald*, for example, pointed out last August, "COSTS PUT A DREAM AT RISK."

Although it's true that the downturn in the economy forced U.S. colleges to make drastic cutbacks, students began leaving college—or began to choose schools on the basis of cost rather than quality—well before the recession hit. Since the mid-1980s escalating tuition costs have forced low-income students into community colleges or out of school altogether, and have either pushed middle-class students into state schools or saddled them with unparalleled debt. Considering that higher education is a primary source of social and economic mobility, this is cause for alarm—especially since tuitions are expected to continue to mount. Tuition and fees now come to more than $20,000 a year at elite private institutions, and the price could jump as high as $40,000 by the year 2000.

Most of the recent articles have alluded to the fact that since 1980 colleges and universities have been increasing their tuition and fees at roughly twice the rate of inflation. None of them, however, has explained why.

Three years ago the higher-education establishment itself attempted to explain the increases. In the late 1980s the American Council on Education, a premier higher-education umbrella organization, and the College Board, the publisher of the annual listing of college costs and the sponsor of the Scholastic Aptitude Test, commissioned Arthur Hauptman, a consultant to both organizations, to account for the unprecedented tuition increases. In April of 1990, after a two-year investigation, they released the results.

The report, a 120-page book called *The College Tuition Spiral*, claims that, essentially, tuitions increased at public colleges because state funding dropped, at private colleges because facilities had been improved and teachers' salaries raised, and at both types of schools because they had to compete for a shrinking pool of college-age youths. "Institutions decided to compete for students through nicer facilities and better services rather than by lowering their prices," Hauptman has said. "That's not a venal decision." A headline in *USA Today* was typical of the largely uncritical press treatment the report received: "TUITION HIKES ARE JUSTIFIED, COLLEGES SAY." Associations and schools affiliated with the American Council on Education embraced the study's conclusions as the official answer. And in November of that year the Department of Education released "The Escalating Costs of Higher Education," a report that included a section supporting Hauptman's core findings. Upon close examination, however, the three major factors that Hauptman identified fail to explain why the price of a college diploma has risen so high so fast.

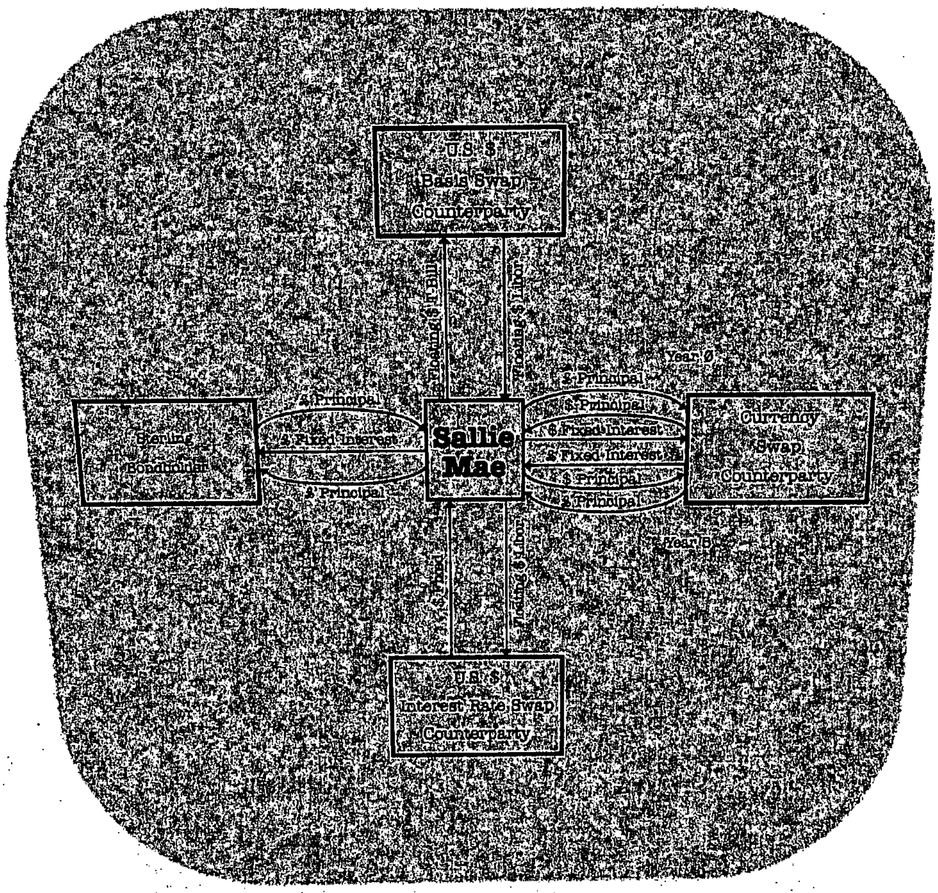
His first assertion, that a downturn in state funding forced public schools to raise tuition, isn't even supported by his own data, which, he states in another section of the report, "do not suggest a slumping in state support for higher education in the 1980s."

Hauptman's second assertion is what some critics have called the Chivas Regal argument. It goes like this: An apparently more pervasive desire for a college education, coupled with a shrinking college-age population, convinced administrators that the way to woo prospective students was to raise faculty salaries, upgrade facilities and programs, and offer more student aid, rather than to cut costs and lower tuition.

"It's clear that what [colleges] spent this money on was not the quality of instruction," Hauptman says. Colleges decided to keep their most affluent "customers" satisfied by gentrifying their campuses and charging for it. As Hauptman says, it was "a good business decision" in a classic buyer's market. If schools didn't keep up with their competitors, matching them natatorium for natatorium, students wouldn't enroll.

Third, Hauptman contends that since private and public schools were faced with a declining pool of eighteen- to twenty-four-year-olds, they could no longer spread their fixed costs over growing numbers of students, as they had in the 1960s and early 1970s. Thus they had to raise tuition. But in the 1980s the number of college students increased at a fairly steady rate. From 1980 to 1990 enrollments rose from 11.4 million to 13.6 million students—a gain of about 20 percent.

ILLUSTRATION BY MARIS BISHOFS



provide funds for loans to parents who are putting their children through college. And Health Education Assistance Loans for prospective health care professionals.

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All told, more than 6.5 million borrowers rely on Sallie Mae for loans to finance every kind of education. At schools all across the country.

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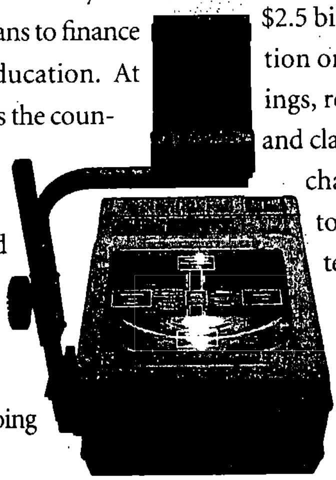

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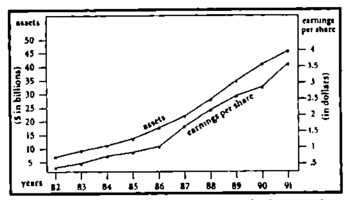

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The flattened-enrollment theory also doesn't explain what amounts to a five-year gap. Enrollments leveled off around 1975, and college officials were aware of demographic trends well before that time, but schools did not raise their tuitions significantly above the rate of inflation until 1980. Tuition actually lagged behind inflation in the late 1970s. Why did colleges and universities wait five years to increase their fees?

The National Coalition for Universities in the Public Interest, an organization co-founded by Ralph Nader in 1983, offers a compelling counterargument to Hauptman's report. It blames tuition inflation on the commercialization of campus-based research. Leonard Minsky, another of the coalition's founders, says that universities are raising tuitions "not to attract more students but to attract corporate investment."

It is a piece of federal legislation passed in 1980 that is to blame for the tuition increases, according to the coalition. The Bayh-Dole Act, also known as the University–Small Business Patent Act, augmented by a subsequent executive order to include multinational corporations, ceded to universities the ownership of patents developed with federal research funds. This enabled schools to attract foreign and U.S. corporate investment, because they could now sell to companies exclusive licenses on all discoveries made under a company's sponsorship. To sweeten the pot, Congress also altered the federal tax code, giving corporations tax credits for investing in university research.

The coalition's theory provides a plausible explanation for Hauptman's mysterious five-year lag time. It suggests that universities promptly started to raise tuition—their only source of unrestricted revenue—to cover the exorbitant venture-capital demands of applied research.

The higher-education establishment, corporations, and both political parties touted the revised patent law as a solution to the nation's competitiveness problem. It was meant to encourage universities to shift their priorities from pure, or basic, research—which rarely has any immediate practical use—to applied research. For universities to do this, however, they would have had to make an up-front investment to modernize laboratories in order to meet industrial standards, and hire industrially qualified scientists at much higher salaries than those they customarily paid. The discoveries resulting from this applied research, so the argument went, would be more easily translated into marketable products, thus making U.S. corporations more competitive. And the universities would recoup their initial investment and earn a profit from royalties on their patent rights.

These patent-law changes, Minsky argues, transformed the overriding purpose of the university: "Formerly, universities had only employees and capital. Now they have products to sell. Once universities become a business, the objective is not 'education for the people' but looking for marketable products and selling the institution to corporate investors."

The coalition charges that the strengthening of ties between universities and industry has amounted to an enormous indirect public subsidy, in the form of federal research dollars and tuition revenue, to private corporations—including ones from Japan and Europe.

"Corporations sponsor research at universities to use public tax dollars to defray the cost of developing marketable inventions and to spread the risk of failure," says David Noble, a professor of history at York University, in Toronto, and another coalition founder. Corporations fund only about eight percent of university research, Noble says. "They're not building the buildings, or paying for the education of the staff, or supporting the students, or the library, or the land, or the accumulated prestige and knowledge of the university. If they had to replicate these resources in-house, it would cost them orders of magnitude more than what they're paying."

The heightened emphasis on capital-intensive applied research has led a number of schools to cut back course offerings and to eliminate entire departments that don't pay for themselves. Columbia University, for example, phased out its geography and linguistics programs in the spring of 1989 and closed its highly regarded graduate school of library service last June. At the same time, the university built the $62 million Morris A. Schapiro Center for Engineering and Physical Science Research.

This retrenchment has prompted a debate among administrators about the role of the university. In a 1989 speech the president of Princeton, Harold Shapiro, said, "Some suggest that undergraduate education 'gets in the way' of frontline and increasingly complex research. Others argue that blockbuster grants for research centers, all of which require some type of cost-sharing, siphon internal funds away from teaching. . . . Should we keep the research and education enterprises together?"

Arthur Hauptman discusses the research-tuition connection in *The College Tuition Spiral*, but as an afterthought. Even so, his four-page abbreviated description of the link confirms much of the coalition's conclusion. And when I described to him the coalition's hypothesis, he endorsed it. "I don't think it's hypothetical," he said. "I think it's true."

Hauptman's study shows that despite laments by many college administrators that federal research funding declined in the 1980s, it actually went up four percent a year. And not all of the increase was associated with Pentagon programs; civilian-sector research budgets grew almost as fast as defense-related activities.

Administrators from elite research universities nonetheless complained to Hauptman that federal spending—which represents about 60 percent of all funds spent for campus-based research—did not increase enough to cover research costs adequately. To compete with industry for scientists and engineers, these schools have had to pay six-figure salaries and provide support staff and state-of-the-art laboratories and equipment—which can add up to millions of dollars a year.

How do they make up for shortfalls? Raise tuition, Hauptman says.

"For many years undergraduate tuitions at many universities have supported research by paying for a substantial portion of the fellowships and assistantships that institutions provide to graduate students," he writes. "But this traditional form of cross-subsidy now appears to have been extended to the use of undergraduate tuitions for the direct support of campus-based research."

Erich Bloch, who finished his six-year term as the director of the National Science Foundation in August of 1990, agrees. "No doubt about it," he says, "[research universities] have supported

(Continued on page 43)

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Angela in 1978.

Angela in 1982.

Angela in 1987.

Angela in 1991.

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❑ Please send my New Sponsor Kit with my sponsored child's photo and case history. My check for $22 for the first month's sponsorship is enclosed.

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❑ Although I can't sponsor right now, I'd like to contribute $__________ to your Emergency Fund.

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(Continued from page 34)
part of their research with tuition funds. . . . Research has become the prime reason for [the university's] existence. At one time it was education."

Both Hauptman and Minsky say that the situation at research universities has had a trickle-down effect on less prestigious state and private institutions. More and more schools "want to be considered world-class," as one former higher-education-association president says. And that means research. It's required for tenure, and many find it more lucrative and stimulating than teaching. It also brings prestige, not only to professors but also to their institutions.

The trend has pulled faculty members out of the classroom and into the lab. Teaching loads have lightened considerably at most institutions in both the sciences and the humanities, and many highly paid star professors never see an undergraduate—they stipulate it in their contracts. This, too, affects tuition, according to a former official of the Bush Administration. In a report released in November of 1990, Lynne Cheney, then the head of the National Endowment for the Humanities, observed that the emphasis on research over teaching had forced schools to hire more instructors, contributing to tuition increases.

Last September a House committee arrived at similar conclusions. In its brief report, "College Education: Paying More and Getting Less," the Select Committee on Children, Youth, and Families laid the blame for tuition inflation on the heightened emphasis on research at schools seeking to emulate Ivy League universities. The recession exacerbated the problem, the report said, by forcing schools to choose between reducing teaching budgets and reducing research budgets. Teaching lost out.

Finally, the fact that many of the top research universities are price leaders, to which other schools look when deciding what to charge, also drives up tuition throughout the system. To try to alleviate a related problem, the federal government recently moved to curb interschool collusion in setting tuition rates and financial-aid awards. After a two-year investigation of about sixty prestigious schools, the Justice Department in late May of 1991 charged the eight Ivy League schools and the Massachusetts Institute of Technology with violating the Sherman Antitrust Act by illegally conspiring to limit price competition on financial aid. To avoid a costly legal battle, the Ivies immediately agreed to stop their thirty-five-year practice of offering uniform financial-aid awards. They also agreed not to exchange information on planned tuition increases or faculty salaries, even though they were not formally accused of doing so. MIT, however, refused to sign the consent decree and was convicted last September of fixing prices on financial-aid packages. Meanwhile, the Justice Department is continuing its investigation of other schools' financial-aid practices.

THE RESEARCH-tuition connection has gained in significance as relationships among universities, government, and business have changed over the past twenty years. In the mid-1970s universities began to look to the business community as a potential ally against "intrusive" federal regulation and as a source of funding to offset flattened federal support. Corporations, sensing an impending return to normalcy on campus after the Vietnam War, warmed to the idea of partnerships. Not only were they interested in rolling back federal regulations, but a marked decline in their ability to compete internationally had them scrambling to find ways to promote productivity and technological innovation. They were also attracted by the growing commercial potential of biotechnology—then the product of campus laboratories. Rather than increase their own in-house research-and-development capacity, which would have reduced their profit margins, they tapped into university research.

A major obstacle for corporations, however, was the patent law. At that time the government owned the patents on discoveries made through federally funded research and licensed them nonexclusively, without charge, on an ad hoc basis. The universities wanted ownership, which would allow them both to license patentable inventions directly to corporations for a royalty and to solicit up-front contributions from corporations. But corporations wanted exclusive licenses. If they were going to help pay for specific university research projects, they wanted their initial investment protected. Otherwise, they argued, there was no incentive to support university research.

Both sectors claimed that changing the law would facilitate "technology transfer"—the transfer of discoveries and inventions from university labs to corporations and then to the marketplace. The paramount argument for patent-law revision, though, was that it would greatly improve the nation's competitive posture in world markets.

Sheldon Steinbach, general counsel for the American Council on Education, began lobbying for the new law in 1974, when he started working closely with Senator Birch Bayh, one of the sponsors of the University–Small Business Patent Act. A few years later Steinbach helped Representative Charles Vanik draft the first research-and-development tax-credit proposal—which Congress eventually passed—to give corporations an additional inducement to support research.

ACE's lobbying efforts thus helped create a situation in which the American public now pays for university research four ways: federal tax dollars underwrite most campus-based research; undergraduate tuitions help pay for labs, scientists, and research assistants; corporations investing in campus research receive tax breaks, which means a loss for the federal treasury; and a corporation with exclusive rights to a patent produced by publicly funded research can sell the product at a monopoly price.

Have campus-corporate ventures strengthened U.S. competitiveness or helped our domestic economy? The number of patents issued to universities has grown considerably, nearly doubling from 619 in 1986 to 1,173 in 1990, according to the Association of University Technology Managers. Despite this boom, however, there have been few bona fide commercial successes. Most of the discoveries have been limited and technical.

Advocates of university-industry partnerships, however, say that ten years is too brief a time over which to evaluate their success. Even so, a former president of Harvard University—the school that has made some of the biggest corporate deals on record—disputes the idea that they will ever significantly strengthen U.S. competitiveness. In his 1990 book *Universities and the Future of America*, Derek Bok writes that it is a "fallacy" that spending more on university research and promoting university-industry ties will "do much to restore the preeminence of American business."

Most experts have concluded that the real problems of American competitiveness do not lie early in the product cycle at the stage of making inventions or even starting new companies. The trouble typically begins in later phases when products must be standardized and produced in large quantities at low prices and high quality.

Bok points out that the Japanese did not invent color television, video recorders, or semi-conductors but they are more efficient at designing and manufacturing state-of-the-art versions.

Another reason university-industry collaboration will not help U.S. competitiveness, the Coalition for Universities in the Public Interest says, is that Japanese and European corporations have the same access to federally funded campus research that U.S. firms do. A number of major universities, most notably the Massachusetts Institute of Technology, have aggressively courted foreign companies, and their efforts have paid off. According to a 1988 study by the General Accounting Office, links with U.S. universities helped Toshiba to develop new technology for recording images on disks, Toyota to devise new engineering stress sensors, and the Asahi Chemical Company to computerize its manufacturing processes.

In June of 1989 a House subcommittee held hearings on the issue and bluntly criticized universities that were selling research results to foreign corporations. The legislators said that such actions undercut the U.S. economy when, ironically, university officials were asking for more federal support for campus research to help U.S. companies compete internationally.

As a follow-up, the subcommittee instructed the GAO to conduct a study of technology transfer from the schools that receive the most federal grant money. The study, published last May, found that twenty-four of the thirty-five universities surveyed had industrial liaison programs with at least one foreign member. In total, 499 foreign corporations were involved, and the programs at MIT, Stanford, and the University of California at Berkeley accounted for 58 percent of them.

The GAO study was incorporated into a report by the House Committee on Government Operations, issued last October, which concluded that "the benefits of publicly funded research are being sold at bargain basement prices to foreign corporations, and that the very programs that were initiated to increase U.S. competitiveness are benefitting our economic competitors instead." Among other things, it recommended that the federal government require schools to give preference to U.S. corporations when granting patent licenses.

David Noble, who was the first to publicize MIT's extensive ties to Japanese corporations, says that such relationships are far from the only problems created by federal patent and tax laws. He argues that these laws are essentially anti-competitive. Exclusive patent licenses give corporations a monopoly on a product for up to seventeen years, but, as Noble points out, "there is no adequate requirement in U.S. patent law that ensures a patent will be worked—that there will be any return to the public." In fact, corporations have sat on patents countless times in the history of science-based industry.

When a corporation does decide to work a patent, it can charge the public whatever it wants. Burroughs Wellcome has been roundly criticized for inflating the price of AZT, the anti-AIDS drug that the National Cancer Institute helped develop. In March of 1991 a group of HIV-infected patients sued the British pharmaceutical firm to strip it of its exclusive patent, alleging that the company misleadingly took credit in its patent application for work done by federal scientists. That suit was ultimately dismissed. But the following July the National Institutes of Health granted a nonexclusive license to manufacture AZT to Barr Laboratories "to the extent that NIH is found to have an inventorship interest in the six AZT-related patents issued to Burroughs Wellcome," according to a statement made by Dr. Bernadine Healy, the director of the NIH. Barr Laboratories and Burroughs Wellcome are involved in litigation that will be decided this May.

In a less well known case Michigan State University and NCI developed cisplatin, an anti-cancer drug, with federal research funding, and the government licensed it exclusively to Bristol-Myers (now Bristol-Myers Squibb). Other drug companies have shown interest in producing generic versions, but Bristol-Myers Squibb controls the original patent in the United States and has kept the drug's price artificially high.

"The exclusive license is the fulcrum," Leonard Minsky says, "allowing corporations to make excessive profits above and beyond the profits that can be made in a competitive situation. Granting corporations tax breaks for funding their own research, and monopoly control of a product developed with federal research dollars, is corporate welfare. These are public handouts designed to make U.S. companies competitive, but they're counter-competitive devices that reinforce the disability they're designed to cure. We are subsidizing an inefficient system."

Over the past forty years federal initiatives have helped open the gates of the academy to women, low-income whites, and racial and ethnic minorities. The commercialization of campus research, however, coupled with the federal government's shift from student-aid grants to loans, has rolled back those gains. Access to higher education is becoming progressively restricted to those students—largely of white, upper-middle-class background—who can pay. The result? Stratification in the college system increasingly mirrors the social stratification that higher education once helped to overcome.

Proponents argue that closer university-industry ties will generate new products and enhance U.S. competitiveness, but little has happened since 1980 to justify the huge public subsidies or the end of affordable education for many Americans.

The policy has sparked little debate on Capitol Hill, where it still enjoys bipartisan support. Even so, the Coalition for Universities in the Public Interest maintains that the commercialization of publicly funded research is an issue as important to the nation's future as environmental protection.

"Just as Americans should be concerned about the regulation of the oil under the ground and the timber above it," David Noble says, "they should also be concerned about this precious and irreplaceable asset—what some call intellectual capital. We have no quarrel with universities acting in any way they want so long as they don't take public funds. But when they do—and nearly all do—to ask the question What's in it for the public? is not only legitimate, it's essential democratic behavior."

—*Elliott Negin*

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To William Galston	From Ed Elmendorf
Co. Deputy Asst. to	Co. AASCU
Dept. The President	Phone # 293-7070
Fax # 456-2878	Fax # 296-5819

April 29, 1993

American Association of State Colleges and Universities

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National Association of State Universities and Land-Grant Colleges

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Dear Colleague:

We are enclosing a letter to you from Secretary of Education Richard W. Riley describing President Clinton's plan to phase in the replacement of the Federal Family Educational Loan Program (FFELP)--formerly known as guaranteed loans--with direct lending.

The President's proposal satisfies essential criteria for a first-rate direct loan program. Indeed, it is structured along the lines of a program we have advocated for over the past two years.

In his letter the Secretary confirms that direct lending:

- Will make loan capital available to all eligible students as an entitlement;
- Will assure availability of loans to all students during the four-year transition to full direct lending;
- Will not impose added administrative costs on institutions;
- Will not require any institution to originate loans; alternative origination will be done by an Education Department contractor.

Obviously, as the legislation moves forward, we, along with the American Council on Education (ACE) and the other associations, will work closely to assure that the final version and its implementing regulations are as sensible and sensitive as possible to the needs of our students and their institutions.

As you know, advocates for the current system have been conducting an extensive lobbying campaign against direct lending targeted at our campuses. The information provided by those advocates for the status quo, who have a significant financial stake in the current system, has been misleading on many key points.

We hope you will examine the information provided by the Secretary and, as convenient, express your views of the Administration's plan to the news media and members of your state's congressional delegation. The House Education and Labor Committee will markup the President's direct loan legislation before May 15. Some colleges and universities have already provided responses to the Congress based on inaccurate information they are receiving. We hope they will be able to reconsider their views based on new information contained in the Secretary's letter.

The budget resolution passed several weeks ago requires the House and Senate education committees to achieve $4.2 billion in savings. Cutting the current guaranteed loan programs is unlikely to achieve that level of savings in a satisfactory manner, and we, of course, are adamant about maintaining and strengthening the Pell Grant and campus-based programs. A thoughtful phase-in of a full direct lending program as proposed by the President will help make major improvements in student loans, will help reduce the deficit and perhaps, down the road, make more funding available for the Pell Grant program.

If you need further information or copies of the actual legislation, please call Jerry Roschwalb at 202-778-0848, Tom Butts at 202-554-0578, Ed Elmendorf at 202-857-1825, or Barmak Nassirian at 202-857-1825.

We are also providing a copy of this information to your federal relations, institutional advancement, and financial aid officers.

Cordially,

Peter

C. Peter Magrath
President
National Association of State
Universities and Land-Grant Colleges

Jim

James B. Appleberry
President
American Association of
State Colleges and Universities

enclosure

UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

Dear Colleague:

President Clinton is now sending two complementary pieces of legislation to Congress on national service and student loan reform. Many of you have been hearing misleading reports of these proposals, put out by organizations with a major financial stake in the status quo. I write to you today to clarify the student loan portion of this bill.

Our primary objective in revamping the student loan system is to serve students better. A new streamlined system will simplify the administrative tasks of educational institutions, make the system easier to understand, provide students with greater choice in repayment plans and lower costs to taxpayers and students.

Make no mistake about four central principles of our proposal:

- No school will be required to originate loans if it does not want to.
- The Department of Education will pay a fee for loan origination.
- Access to student loan capital will continue to be an entitlement.
- There will be no gaps in access to capital for any eligible student or parent.

President Clinton is deeply committed to increasing educational opportunity by providing young people with the chance to serve their country and their communities. In return for their commitment, he intends to help them meet the costs of a college education or job training. The National Service program will provide educational benefits in return for national service performed before, during and after college. The Department of Education will implement a direct student loan program that will provide all students with a range of flexible repayment options, including income contingent repayment. Under this program, students who choose to take low-paying community service jobs, whether part of the national service program or not, will be able to repay their loans as a small percentage of their income so that they will not be overburdened by debt.

The major savings from direct lending derives from using Federal borrowing for student loans rather than private capital guaranteed by the Federal government and eliminating the profits in the system. The cost estimates include a significant allowance for administrative costs to the Department of Education and educational institutions. Eligible schools will originate loans if they chose to do so, and they will receive a small fee from the Department of Education to help cover costs. Nonetheless, I understand that not every institution will be able to originate loans, and some will not want to. In these cases, an alternative originator will be available at no cost to the institution. We are confident that a new system will prove easier to use, more efficient for institutions and students, and much less costly than the current student loan structure.

Please take the time to read the enclosed background material, which addresses many of the specific issues raised by the opponents of direct lending. If I can be of further assistance, please contact the Department at (800)USA-LEARN.

We look forward to your support of this plan to serve students, families, and schools better.

Sincerely yours,

Dick Riley

Richard W. Riley

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-0100

Direct Lending

Background Material for Educational Institutions

April, 1993

Major Reasons For Direct Lending

Greater Efficiency and Simplicity

The current system of 7,800 lenders, 46 guarantee agencies, and numerous servicers and secondary markets is error-prone, hard to monitor, and cumbersome to borrowers and schools. Each of these lenders and agencies has its own forms and procedures, adding extra work for borrowers and schools. Under direct lending, the process would be greatly simplified and streamlined because students could arrange for all of their Federal financial assistance through their schools. They would have only one application form to fill out, and they would no longer be confused about who holds their loan notes or where to send repayments. The school, in turn, would no longer have to work within the current complicated web of banks and guarantee agencies. For example, schools would no longer face cash flow delays due to bank or guarantee agency approvals. Educational institutions would provide, in essence, one-stop shopping for students, which permits a school to offer better and more comprehensive service.

Cost Savings to Student Borrowers

Borrowers will continue to have access to as much loan capital as they have had in the past. Direct loan capital will not be limited by congressional appropriations. This program will be an entitlement for students, just like the guaranteed student loan program. Funds will flow promptly to schools, solely on the basis of borrower eligibility and needs. Once the system is fully implemented, a portion of the general cost savings from direct lending will be passed on to borrowers in the form of a reduction in the interest rate on their loans.

Flexible Repayment Options

All students who borrow money for school will have available a range of flexible repayment options to suit their financial needs. Under these options, any student who chooses to take a low-paying community service job, or any low-paying job, will not be overburdened with debt. Students who choose the income contigent repayment plan will repay their loans as a small percentage of their income. Other students will be able to choose a fixed, graduated, or extended repayment plan that fits their needs. Eventually, we plan to make repayment even easier by the use of payroll withholding through the tax system. Students in any additional costs, the Department of Education will pay them a small fee to help cover the costs of origination. Those schools that cannot or do not wish to originate loans will not be obligated to do so. The Department will pay an alternative originator to perform this task for these schools. Furthermore, educational institutions will not be expected to service or collect the loans (except for the routine tracking of student status which schools already do). The Department will contract with a number of organizations to perform servicing and collection of direct loans.

Administrative Capacity at the Department of Education

There is no question that the Department must strengthen its monitoring and review functions, but we must do so regardless of whether the current program continues or we move to direct lending. Loan servicing will be done by a small number of carefully selected and closely monitored contractors. The direct lending system would have fewer administrative participants and thus would be easier for the Department to monitor. We have made significant progress in some areas, including improved management and computer systems. The Department's delivery of direct loan funds will include many of the well-tested, successful, and increasingly automated data and financial systems now used for Pell Grants and campus-based Federal student aid programs. To ensure high quality, the Department is working on redesigning program integrity and monitoring efforts to focus on performance outcomes. This will lead to increased accountability and efficiency.

Serving Students During the Transition

Both during and after the transition to student loans, maintaining the availability of loans to students will be our number one priority. For a long time, lenders have maintained the status quo by using threats of pulling out and disrupting the flow of loans to students. The Department is aware of the challenges in moving to a new system and we are working to ensure a smooth transition. The legislation will provide the Department with authority to move quickly if capital shortages occur.

community service jobs funded by the national service program will receive an educational benefit of up to $6,500 for every year of service that they perform, up to two years. They can use this benefit to pay off loan debt or to pay tuition.

Cost Savings to Taxpayers

The expected savings from direct lending – estimated at roughly $4 billion from FY 1994 to 1998 – will greatly reduce the costs of student loans to taxpayers. The Congressional Budget Office, the General Accounting Office, and the Department of Education agree that direct lending could save $1 billion or more per year when fully implemented. Because of the government's relatively low cost of capital, the taxpayer's cost of providing interest subsidies to borrowers would be substantially reduced – by about 10 cents per dollar loaned.

Responses to Concerns Raised About Direct Lending

Despite the many reasons to move to direct lending, some opposition remains. This opposition has naturally come from those who have profited most from the current guaranteed loan program. Some of these concerns are valid, and we have designed our proposals to address them; other concerns are not.

Administrative Capacity at Educational Institutions

Many of you have heard that it will be complicated and expensive for schools to participate in direct lending. This is simply not true. According to the independent Advisory Committee on Student Financial Assistance, the burden on most institutions will be radically reduced because schools will only have to deal with one central application, one disbursement processing system, and electronic communication with one servicer. The new activity that direct lending requires is origination. While no school will be required to originate loans, those schools that choose to originate must perform two new functions: 1) ensure that students sign the promissory note to repay the loan and mail it to the servicer, and 2) after making the loan, reconcile with the servicer that all the money and documentation is accounted for. The Department of Education will provide software to accomplish both of these tasks. The software, as well as training to use it, will be available to institutions free of charge.

Most schools already have the technology and experience needed to participate in direct lending as loan originators. If your institution originates loans in the Perkins Loan program, it has the capacity to originate loans for direct lending. To ensure that institutions do not face

American Association of State Colleges and Universities

NEWSBREAK

aascu One Dupont Circle / Suite 700 / Washington, D.C. 20036 (202) 293-7070

For Immediate Release April 30, 1993

Contact: Gay Clyburn or Sam Snead
Division of Communications

Statement from James B. Appleberry President, American Association of State Colleges and Universities on President Clinton's National Service Initiative

Service to community and society has been one of the hallmarks of America's state colleges and universities in addition to teaching and scholarship. President Clinton's proposed National Service Initiative is to be commended and supported for the opportunity it provides college and university students to develop a sense of community and a commitment to serve our nation and fellow citizens throughout life. For this reason, among others, it is fitting that the American Association of State Colleges and Universities (AASCU) supports President Clinton's carefully crafted National Service Initiative.

Listed as a component but separate in its impact and benefit is the President's initiative to establish a Direct Lending Program. The program provides a more efficient mechanism of loan financing, a campus-based streamlined loan process and flexible repayment options for students. The Direct Lending Program's connection to the National Service Initiative is through its proposal for debt forgiveness in return for service for a limited number of students. It is the belief in the value of service to the community and the nation that motivates the connection of these two worthy initiatives.

Direct lending calls for a phased in replacement of the current Guaranteed Student Loan programs and includes a limited option income-contingent repayment plan. A tightly controlled and limited option income-contingent repayment plan for students who are unable to handle regular repayments combined with direct lending is clearly a more flexible system than the current mechanisms of loan financing and AASCU supports this plan.

AASCU joins President Clinton in his view that a number of fundamental changes must be implemented in the current system of federal support for higher education.

-more-

Add 1
Statement

The disturbing trend of excessive student indebtedness, the steady erosion of federal grant support and actual cutbacks in state investment in postsecondary education must be quickly reversed for American public higher education to maintain its current position of world leadership. It is by providing affordable access to our public colleges and universities that people of color, our emerging immigrant populations, and our economically disadvantaged citizens will help this nation retain its leadership in the world.

AASCU endorses the President's proposal for national service and applauds his long held commitment to higher education access, and we're hopeful that because of this commitment, resources will not be diverted from need-based federal student aid programs as the administration looks for ways to finance this worthy initiative.

AASCU is a Washington-based higher education association representing more than 375 state colleges and universities and 30 systems, educating one in five of the nation's college students.

-30-

National Association
of Independent
Colleges and Universities

May 11, 1993

National Association
of Independent
Colleges and Universities
naicu
122 C Street, N.W. • Suite 750 • Washington, D.C. 20001-2190
Jane V. Wellman
Vice President for Government Relations
202/347-7512
FAX 202/628-2513

The Honorable William D. Ford
Chairman
Committee on Education and Labor
U.S. House of Representatives
Washington, D.C. 20515

Dear Bill:

I am writing on behalf of the National Associat[illegible] Independent Colleges and Universities (NAICU) with regard to the Student Loan Reform Act of 1993. This bill brings about the most significant changes in the federal student financial aid programs since the passage of the Higher Education Act twenty-eight years ago. The changes you make are of vital importance to the one million students who attend independent institutions with loan assistance. We believe the bill is a solid one that deserves your support.

We realize that keeping the present loan delivery system is not possible. The mandated $4.3 billion savings over five years from educational entitlement spending realistically can only come from an overhaul of the federal student loan program. Toward this end, the NAICU Board of Directors adopted a set of priorities to use in evaluating loan program proposals. We have used these criteria to analyze the administration's bill; and we will also apply it to any other loan reform proposal that may come forward.

We are pleased that the proposed legislation meets many of our highest priorities.

- **The loan program will continue to operate as an entitlement.** Students will have continuous access to capital during the transition from the current program to direct lending. This is assured by a provision for contingency arrangements, including a revised role for Sallie Mae to serve as a loan originator and lender of last resort.

- **Income-contingent repayment options would be available for all borrowers.** Borrowers in repayment could move from one kind of repayment to another if their income changed.

- **Institutions that have the administrative capacity to originate loans, but choose not to do so, would have their loans originated by an outside agency under contract with the Department of Education.** Likewise, institutions that do not have the administrative capacity to originate loans, as measured by the department, would use outside contractors. The costs for these options would be paid by the department.

- **Institutions that originate loans would be reimbursed for the "marginal" costs of direct lending, although the specific fee structure must still be negotiated.** The bill would provide higher reimbursement for small institutions that would have higher administrative costs per loan.

- **Institutions would have no responsibility for servicing or collecting the loans.** This function would be performed by entities operating under contract to the department, at no cost to the institutions.

However, there are a number of student concerns with the president's bill, and we request that the committee consider changes in the following areas:

- Student origination fees should be reduced or eliminated.

- Savings from direct lending should go toward reducing the interest paid by borrowers.

- There is no limit to the number of years a student can remain in repayment. The details of income-contingent repayments and the potential role of the Internal Revenue Service should be clarified.

- Excessive administrative authority on a number of provisions is left to the Department of Education. We believe these issues are of sufficient importance on a polilcy basis that more should be in statute: criteria for determining institutional participation and reimbursement of institutions for costs; the selection criteria for contractors and alternative originators; and the evaluation process.

We believe the Student Loan Reform Act of 1993 is fundamentally sound and can be made to work. We also believe it can be improved with amendments. We look forward to working with you as you continue to develop plans for a restructured loan program.

Sincerely,

Richard F. Rosser

Richard F. Rosser
President

RFR:blk

STUDENT LOAN MARKETING ASSOCIATION
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007-3871
202-298-2600

LAWRENCE A. HOUGH
President and
Chief Executive Officer

May 12, 1993

The Honorable William D. Ford
Chairman
Committee on Education and Labor
2107 Rayburn House Office Building
Washington, DC 20515-2215

Dear Mr. Chairman:

As a follow-up to our discussions yesterday concerning Sallie Mae's GSE status and our company's view that it is time to reexamine that status, I am forwarding two draft legislative proposals. The first contains a definitive plan to convert Sallie Mae's charter from a special GSE charter to an ordinary state corporate charter and to eliminate, over a three year transition period, any implicit taxpayer risk associated with our $45 billion of outstanding liabilities. As I indicated, this plan had been discussed with various executive branch officials and appeared to be generally favorably received. However, given the shortness of time and the political sensitivities involved, the Administration opted instead to propose a six month study.

As an alternative, the second legislative proposal enclosed is a mandate to the Secretaries of Education and Treasury to submit to your committee a joint legislative proposal to transition Sallie Mae to the private sector, together with a report on the economic impact and policy implications of such a transition. Given the importance of this issue to our customers, employees and investors, we feel strongly that it would be preferable for the Congress to call for action rather than a study.

Any special roles or functions the Congress or the Secretary of Education wishes Sallie Mae to perform during any transition period and beyond, which may include lender of last resort, guarantor management, or direct loan servicing, could be outlined in either legislative proposal, with specific terms to be negotiated by contract between the Secretary and the Association or its successor.

Also, as you requested, enclosed are proposed revisions to Congressman Goodling's draft amendment which meet the Administration's objective of using an alternative delivery system and addresses the widely held belief that the existing system should not be abandoned. This proposal assumes that the Administration's direct loan program will be an option in which schools could elect to participate. Schools would elect the system which best meets their needs and the needs of their students. The proposal is intended to make reforms to the current student loan program and to achieve the budget savings targets without jeopardizing access to student credit.

The proposal calls for the reductions in lender yields and increased lender risk sharing developed by Congressman Goodling. It also relies on Sallie Mae to be a lender of last resort, an objective contained in his package and in the Administration's bill. To achieve this result, the Goodling proposal has been modified as set forth in the enclosure.

I appreciate your willingness to consider the options Congress has to meet its obligations under the Budget Resolution, to satisfy the Administration's desire to change the delivery system, and to serve the interest of students and schools. Again, thank you for meeting with us yesterday.

Sincerely,

Larry Hough

Lawrence A. Hough
President and
Chief Executive Officer

Enclosures

SALLIE MAE CHARTER CONVERSION

SUMMARY:

This approach contemplates a rechartering of the Student Loan Marketing Association after approximately a three year transition period by converting the federally-chartered entity into a state-chartered corporation that would have no GSE attributes, but whose balance sheet would contain all of the assets and liabilities of the former GSE. A AAA-rated trust would be created at the end of the three-year transition to protect the government's implicit guarantee of remaining GSE bonds.

MECHANICS:

Congress passes the conversion legislation sometime in 1993 and mandates conversion of Sallie Mae's charter to occur on January 7, 1997 (the final maturity of Sallie Mae's $5 billion borrowings through the Federal Financing Bank). The conversion is effected by a merger of Sallie Mae into a new company incorporated under state law which, as a result of the merger, acquires the assets and liabilities of Sallie Mae.

ACTIVITIES DURING TRANSITION:

During the transition period, Sallie Mae would continue to operate as a GSE and remain active in the student loan secondary market, subject to all the privileges and limitations of its current charter. Sallie Mae may engage in non-GSE activities during this period provided they are funded with non-GSE borrowings or retained earnings and conducted through separate subsidiaries. Sallie Mae and any existing or newly created subsidiaries shall be consolidated, as required by GAAP, for financial reporting and capital adequacy purposes during the transition period as required by GAAP.

To limit the issuance of "excess" GSE debt during the transition, total GSE debt outstanding at any time could not exceed the level of total outstanding liabilities of the Company at the beginning of the transition period, plus the growth in the Company's student loan and other program asset portfolios.

POST-CONVERSION ACTIVITIES:

After the merger, the new corporation would remain an eligible lender under the Higher Education Act for secondary market purposes and continue to facilitate and provide higher education credit, servicing assistance and academic facilities financing.

TREATMENT OF GSE DEBT:

During the transition period, debt issued with maturities prior to 1/7/97 will be treated as GSE debt and debt issued with maturities beyond 1/7/97 will be treated as corporate (non-GSE) debt, subject to SEC registration.

GSE debt issued prior to enactment of the legislation and scheduled to mature after the charter conversion will retain its GSE status and attributes, including SEC exemption, legal investment status, Fedwire book-entry eligibility and state tax exemption. All such residual GSE debt will have to be secured through a AAA-rated trust. This trust is designed to protect taxpayers' from the risk of the perceived implicit guarantee which would remain associated with those obligations to the same extent it applies to other GSE debt. It is estimated that this secured debt could total approximately $5-$7 billion. More than three-quarters of the secured debt would mature within two years of the charter conversion.

103D CONGRESS
1ST SESSION

To amend Part B of Title IV of the Higher Education Act of 1965 to provide for the rechartering of the Student Loan Marketing Association.

IN THE HOUSE OF REPRESENTATIVES
[ ], 1993
Mr(s) introduced the following bill; which was referred to the Committee on

A BILL

To amend Part B of Title IV of the Higher Education Act of 1965 to provide for the rechartering of the Student Loan Marketing Association.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as "The Student Loan Marketing Association Charter Conversion Act of 1993."

SEC. 2. FINDINGS AND PURPOSE:

(a) Findings. The Congress hereby finds that -

(1) the Student Loan Marketing Association, since its creation by Congress in 1972, has successfully developed a national secondary market in student loans, providing stability and liquidity to the market for student loans and facilitating access to loans for all eligible borrowers;

(2) today, student loans are bought and sold in secondary markets in a competitive environment that no longer requires Congress' chartering of the Student Loan Marketing Association as a government-sponsored enterprise on a long term basis;

(3) the risk to taxpayers that arises from any implicit government guarantee that government-sponsored enterprise liabilities may carry should be limited;

(4) it is in the national interest to protect private investment in public purpose enterprises and to ensure that a continued and stable source of funding is available for education purposes;

(5) it is timely and appropriate to fully transition the Student Loan Marketing Association to the private sector.

(b) Purpose. It is the purpose of this Act to -

(1) recharter the Student Loan Marketing Association by merging it into a state-chartered business corporation and ending the Association's existence as a government-sponsored enterprise; and

(2) ensure that such successor state-chartered business corporation may continue to operate as a student loan secondary market and conduct other business as an exclusively private-sector entity.

SEC. 3. THE STUDENT LOAN MARKETING ASSOCIATION CHARTER CONVERSION.

The Higher Education Act of 1965 [20 U.S.C. §1071 et seq. (1988)] is amended by adding at the end of 20 U.S.C. §1087-2 the following new subsection:

"SECTION 1087-2a CONVERSION OF THE STUDENT LOAN MARKETING ASSOCIATION'S FEDERAL CHARTER

"**(a) Purpose** - it is the purpose of this section to provide for the conversion of the Association's Federal charter to a state or District of Columbia corporate charter;

"(b) Establishment, Powers and Organization of Successor Corporation.

"**(1) Establishment** - The Association shall cause the formation of, under the laws of any State of the United States or the District of Columbia, the New Corporation into which the Association shall, in accordance with the terms of this section, be merged, effective at the Effective Time. At the Effective Time, the surviving corporation of the Charter Conversion shall be the New Corporation and the separate existence of the Association shall cease.

"**(A)** The Board of Directors of the Association shall take or cause to be taken all such action as it deems necessary or appropriate to establish the New Corporation and to effect the Charter Conversion.

"**(B)** The name of the New Corporation may be (to the extent permitted by the applicable State or District of Columbia law), or contain, "Student Loan Marketing Association", or "Sallie Mae", or variations thereof or such other name as the Board of Directors of the Association shall deem appropriate.

"**(2) Powers of the New Corporation** - The New Corporation shall have all such powers and authorities as are set forth in its charter or like instrument (as amended from time to time) and by-laws (as amended from time to time) and those which are conferred upon corporations established under the laws of the jurisdiction of its incorporation.

"**(3) Transition** - Except as specifically provided herein, until the Effective Time, the Association shall continue to have all of the rights, privileges and obligations set forth in, and shall be subject to all of the limitations and restrictions of, Section 439 of the Higher Education Act [20 U.S.C. §1087-2] as in effect on the effective date of this Act;

"**(4) Effect of the Charter Conversion** - The Charter Conversion will have the legal effect as set forth in the applicable law of the jurisdiction of incorporation of the New Corporation. Notwithstanding the foregoing, creditors shall look solely to the New Corporation (except as provided for in section 1087-2a(b)(5) hereof) or its successor for the satisfaction of their rights and not to any agency or instrumentality of the United States.

"**(5) Collateralization of Certain Outstanding Debt Obligations** - The Board of Directors of the Association shall arrange for all of the Secured Obligations to be assumed by the Trustee in exchange for the transfer by the Association of monetary assets in such amount and of such kind as to ensure that the assumed obligations of the trust qualify for the highest credit rating from a nationally recognized bond rating agency and the Association shall enter into an agreement with the Trustee to take or cause to be taken all such action as may be necessary to maintain such rating until such time as all Secured Obligations are paid in full. For all purposes of federal law, the Secured Obligations shall retain, until maturity, all Pre-existing Attributes of their status as obligations of the Association. From time to time, the New Corporation shall be entitled to receive any funds or assets remaining in the trust in excess of the amount required to maintain the requisite credit rating. The foregoing arrangements shall not relieve the New Corporation of its payment obligations in respect of the Secured Obligations.

"**(6) Obligations Issued After the Effective Date of the Act** -

"**(A)** All obligations issued by the Association after the effective date of this Act with maturities prior to the Effective Time shall, for all purposes of federal law, carry all Pre-existing Attributes and shall be issued by the Association as required under section 439(h)(1) of the Higher Education Act, with the approval of the Secretary of Treasury.

"**(B)** All obligations issued by the Association after the effective date of this Act with maturities after the Effective Time shall not be required to be approved by the Secretary of Treasury and shall not carry any of the Pre-existing Attributes. Such obligations shall have such terms, conditions and attributes as may be determined by the Board of Directors of the Association.

"**(7) Limitation on Obligations Outstanding** - After the effective date of this Act and through the Effective Time, the total dollar amount outstanding of those obligations of the Association which retain the Pre-existing Attributes shall not exceed the sum of (A) the total dollar amount outstanding of all obligations of the Association on the effective date of this Act and (B) the total dollar amount of the Association's investments after the effective date of this Act in additional assets permitted to be acquired under sections 439(d), (e), (o), (p) and (q) of the Higher Education Act.

"(8) **Status of New Corporation as Eligible Holder** - From and after the Effective Time, all references in Section 428C, Sections 435(d)(1)(F) and (G), and Section 485A(f)(1) of the Higher Education Act, shall be deemed to be references to the New Corporation. The New Corporation shall, for the purposes of purchasing and holding loans, be deemed to be an eligible lender under section 719(2) of the Public Health Service Act [42 U.S.C. §294a(c).

"(9) **Perfection of Liens** - Notwithstanding the provisions of any State law to the contrary, including the Uniform Commercial Code as in effect in any State and in the District of Columbia, a security interest in insured student loans created on behalf of the Association, the New Corporation or any eligible lender (as defined in Section 435 of the Higher Education Act, may be perfected either through the taking of possession of such loans or by the filing of notice of such security interest in such loans in the manner provided by such State law for perfection of security interests in accounts.

"(10) **Association Activities Prior to Effective Time** -

"(A) Notwithstanding any other provisions of the Higher Education Act, after the effective date of this Act, the Association may conduct such activities and undertakings not otherwise specified as permitted under the Higher Education Act as the Board of Directors of the Association deems in its business judgment to be appropriate. All such new programs and activities, to the extent not of an incidental nature, shall be conducted through separate subsidiaries and financed with retained earnings, obligations issued pursuant to section 6(B) hereof, or obligations of any of the Association's subsidiaries. This provision does not limit in any way whatsoever the authority and powers previously granted to the Association under the Higher Education Act.

"(B) After the effective date of this Act and before the Effective Time, the Association and its subsidiaries, including those subsidiaries existing on the effective date of this Act and any formed or acquired thereafter, will be consolidated as required under generally accepted accounting principles for purposes of financial reporting and calculating the capital adequacy ratios contained in Section 439(r) of the Higher Education Act.

"(C) For the purposes of determining whether the Association is a registrant entitled under 17 C.F.R. §239.13, or any successor regulation, to use SEC Form S-3, or any successor form, for registration of its securities under the Securities Act of 1933, as amended [15 U.S.C. §77a-77aa (1988)], the Association shall be deemed to have met the conditions set forth in Instruction I(A)(3) of 17 C.F.R. §239.13.

"(D) Add a new paragraph (F) to section 439(b)(10) as follows:

> (F) Notwithstanding any other provision of Part B of Title IV of the Higher Education Act, any credit support provided by the Association to student loan revenue obligations and facilities obligations pursuant to Section 439(d) of the Higher Education Act prior to the Effective Time shall be deemed for its full term to be an exempt security within the meaning of laws administered by the Securities and Exchange Commission.

SEC. 4. TECHNICAL AMENDMENTS.

As of the Effective Time, the Higher Education Act shall be amended by:

(1) Deleting Subsection 428(h) in its entirety.

(2) Deleting from Subsection 435(d)(1)(G) "and 439(q)" and adding, "and" between "428B(d)" and "428C".

(3) Deleting from Subsection 438(b)(5)(A)(ii), "or 439(o)" and adding, "or" between "428B" and 428C".

(4) Deleting from Subsection 438(c)(2), "and 439(o)" and adding, "and" between 428B and 428C.

(5) Deleting from Subsection 485A(a) the following: "(and section 439(o) of this Act as in effect prior to the enactment of section 428C)".

Section 439 of the Higher Education Act shall be repealed as of the Effective Time.

SEC. 6. DEFINITIONS

For purposes of this Act -

(1) The term "Association" means the Student Loan Marketing Association;

(2) The term "Charter Conversion" means the merger of the Association into the New Corporation;

(3) The term "Higher Education Act" means the Higher Education Act of 1965, as amended, Title IV, Part B.

(4) The term "New Corporation" means the new business corporation formed by the Association under the laws of any State of the United States or the District of Columbia;

(5) The term "Effective Time" means January 7, 1997;

(6) The term "Secured Obligations" means all debt obligations of the Association issued prior to the effective date of this Act and outstanding immediately prior to the Effective Time;

(7) The term "Trustee" means a qualified trustee who will assume the Secured Obligations; and

(8) The term "Pre-existing Attributes" means all of the pre-existing attributes accorded the obligations of the Association by Section 439 of the Higher Education Act, including but not limited to, exemption from state and local taxation of interest payments, lawful investment status for all fiduciary trust and public funds, eligibility for trading and payment processing on the book-entry system of the Federal Reserve Banks and exemption from the registration and reporting laws administered by the Securities and Exchange Commission.

SEC. 7. EFFECTIVE DATE.

Except as otherwise explicitly provided in any provision of this Act, this Act and the amendments made by this Act shall take effect on the date of enactment of this Act.

ANNOTATION

SECTION 1. SHORT TITLE

This provision sets forth the title of the proposed legislation.

SEC. 2. FINDINGS AND PURPOSES

A. Findings.

This section sets forth Congress' findings with respect to the proposed legislation in which Congress acknowledges the achievement by the Association of its original legislative purpose to serve as a secondary market and warehousing facility for student loans and, due to the Association's financial success and the competitive nature of today's secondary market for student loans, that it is no longer necessary for the government to support the Association's activities as a federally-chartered government-sponsored enterprise ("GSE"). The findings also recognize the benefit of limiting any of the government's implied guarantee of GSE liabilities, which in the Association's case totals approximately $40 billion.

B. Purposes

This section states explicitly that the purpose of the Act is to provide for the conversion of the Association's federal charter into a state-charter and to ensure that the Association may continue to operate as a secondary market for student loans. The Act also provides the Association with the authority and flexibility to pursue other business activities beyond the scope of the Higher Education Act.

SEC 3. THE STUDENT LOAN MARKETING ASSOCIATION CHARTER CONVERSION

This section provides for conversion of the Association's federal charter to a State or District of Columbia corporate charter by amending the Higher Education Act to insert a new section setting forth the terms, conditions and procedures by which this would be accomplished.

(a) Purpose - While the purpose of the proposed legislation is described as being to provide for the conversion of the Association's charter from a special charter to an ordinary corporate state charter, the intended effect is to transform the Association from a corporation with special status as a Federally-sponsored quasi-public entity to a private sector entity that is incorporated under and governed by state or District of Columbia corporation law.

(b) Establishment, Powers and Organization of Successor Corporation - (1) It is believed that the most efficient means to effect the rechartering would be for the Association to merge into a newly-formed corporation (the "New Corporation"). The effective time of the charter conversion (the "Effective Time") is January 7, 1997. This would provide adequate time for an orderly transition. The date selected as the Effective Time is also designed to coincide with the last maturity of the Association's obligations held by the Federal Financing Bank.

(A) Since it is intended that, immediately after the merger, the New Corporation would continue the Association's present operations, the Board of Directors of the Association was deemed to be in the best position, by overseeing and directing the process of rechartering in accordance with the proposed legislation, to ensure that the objective of continuity is achieved.

(B) This provision provides that the name of the New Corporation may, to the extent permitted by applicable law, contain "Student Loan Marketing Association", or "Sallie Mae" or variations thereof.

(2) Powers of the New Corporation - This provision explains that the powers and authorities of the New Corporation will be determined by reference to the law of the New Corporation's jurisdiction of incorporation and the contents of its charter and bylaws.

(3) Transition - This provision makes explicit the intention that the Association shall continue to operate, be subject to and have the rights and limitations provided for under current provisions of § 439 of the Higher Education Act until the Effective Time.

(4) Effect of the Charter Conversion - This provision provides that the Charter Conversion will have the legal effect set forth in the laws of the New Corporation's jurisdiction of incorporation and makes clear that creditors may not look to the government for satisfaction of their rights.

(5) Collateralization of Certain Outstanding Debt Obligations - This provision provides for the collateralization of the Association's obligations issued prior to enactment of the proposed legislation and still outstanding immediately prior to the Effective Time (the "Secured Obligations"). Repayment will be secured through a AAA-rated trust funded by monetary assets provided by the Association. The Secured Obligations

will retain their GSE status and attributes, including, but not limited to, SEC exemption, legal investment status, Fedwire book-entry eligibility and state tax exemption (the "Pre-existing Attributes"). Excess collateral in the trust will be released periodically, so long as such release does not affect the trust's original credit rating. The New Corporation will not be relieved of any payment obligations under the Secured Obligations.

(6) Obligations Issued After the Effective Date of this Act - (A) This provision ensures that Association obligations issued during the transition period which mature prior to the Effective Time will be approved by the Secretary of Treasury and carry all of the Pre-existing Attributes.

(B) This provision ensures that those obligations issued during the transition period with maturities after the Effective Time will be treated as, and have the attributes of, ordinary corporate obligations.

(7) Limitation on Obligations Outstanding - This provision limits the total dollar amount outstanding of debt with the Pre-existing Attributes during the transition period to the total dollar amount of liabilities existing as of the effective date of the Act plus any growth in the Association's investment in additional

assets permitted to be acquired by the Association under Sections 439(d), (e), (o), (p) and (q) of the Higher Education Act during such period. This provision is included to address the administration's concerns that the transition period might otherwise permit "excess" GSE funding
activity.

(8) Eligible Holder Status of New Corporation - This provision ensures that after the Reorganization, the New Corporation will be entitled to purchase and hold student loans.

(9) Perfection of Liens - This continues the provision now contained in the Higher Education Act which enables the Association and certain others to perfect a security interest in insured student loans by the simplified method of notice filing rather than by taking possession of such loans, as would otherwise typically be required by state law. This provision has been in effect for many years and is the basis upon which having security arrangements in student loan financings are principally structured.

(10) Association Activities Prior to Effective Time - (A) This provision grants the Association the authority during the transition period to undertake

activities other than those proscribed in the Higher Education Act. Such activities, to the extent not incidental, shall be conducted through separate subsidiaries and financed with retained earnings or by the issuance of ordinary corporate type obligations.

(B) This provision requires the Association and its subsidiaries to be consolidated, as required by GAAP, during the transition period for financial reporting and capital adequacy purposes.

(C) During the transition period, when the Association issues ordinary corporate obligations, the Association and its security holders would be required to comply with:

A. the Securities Act of 1933, as amended (the "Securities Act"), respecting the registration of securities offered to the public;

B. the Securities Exchange Act of 1934, as amended (the "Exchange Act"), respecting, among other things, periodic reporting, proxy solicitation and trading of securities; and

C. the Trust Indenture Act of 1939, as amended, respecting the qualification of indentures relating to certain debt securities.

This provision would enable the Association to use the shortened Form S-3 for registration of its securities immediately, rather than after making twelve months of Exchange Act filings as presently required by the Securities Act. Because of its present exemption from the Exchange Act, the Association has not had securities registered thereunder and has therefore not been subject to the reporting requirements for the prescribed period in order to meet the conditions under the Securities Act for use of the shortened registration form. However, because of its substantial experience as an issuer of securities in the market, its history of being listed on the New York Stock Exchange and its practice of providing disclosure in its offering documents substantially in compliance with the Securities Act, the Association is sufficiently "seasoned" to justify use of Form S-3.

(D) This provision would enable the Association to continue to provide credit support for student loan revenue obligations during the transition period without requiring that such credit support, which constitutes a separate security, be registered under the Securities Act of 1933. Student loan revenue bonds are exempt from SEC registration as municipal securities. Without the proposed clarification, there could be market disruption in Sallie Mae insured bonds that mature after the Effective Time (including approximately $.8 billion of such bonds currently outstanding).

SEC 4. TECHNICAL AMENDMENTS

The substantive changes set forth above require the following conforming technical changes to the Higher Education Act:

(1) Section 428(h) is the counterpart to Section 439(p) of the Association's existing statutory charter, which is being deleted, as discussed below. Section 439(p) authorizes the Association to make loans to guaranty agencies and state lenders for the specific purpose of making loans to students; Section 428(h) authorizes guaranty agencies and state lenders to receive such loans and regulates their use and amount. The New Corporation will be able to make, without specific authorization, the type of loans referred to in these provisions. Similarly, guaranty agencies and state lenders should, under other authorities, be able to receive loans from the New Corporation to make student loans.

(2) This provision also eliminates a cross reference to a deleted provision of the Association's existing charter -- Section 439(q). This provision authorizes the Association to be a lender-of-last resort in certain situations.

(3) These changes remove references to an

outdated loan consolidation program administered solely by the Association. Consolidation loans are now made under Section 428C rather than Section 439(o).

SEC. 5. REPEAL OF SECTION 439

At the Effective Time, Section 439 of the Higher Education Act (the Association's existing charter) will be of no force or effect and will be deleted.

SEC. 6. DEFINITIONS

This section sets forth the defined terms used throughout the proposed legislation.

SEC. 7. EFFECTIVE DATE

This section sets forth the date as of which the proposed legislation would take effect. As discussed below, it is intended that there would be an approximately 3-year period between the effective date of the legislation and that of the Charter Conversion to allow a reasonable transition period to complete necessary arrangements before the Association is reincorporated as a state-chartered, private corporation.

SALLIE MAE CHARTER CONVERSION PROPOSAL

No later than 60 days after the effective date of this Act, the Secretary of Treasury and the Secretary of Education shall present to the Chairman and ranking minority member of the House Committee on Eduation and Labor, a joint legislative proposal that would enable the Student Loan Marketing Association, through an orderly transition process, to be rechartered under state law and continue its corporate existence independent of any special federal sponsorship. The proposal shall be accompanied by a report addressing the economic and public policy implications of the proposed change in the status of the Association and the anticipated effects of such change on students and taxpayers as well as on the Association's creditors, shareholders, customers and employees.

SUGGESTED REVISIONS TO THE GOODLING PROPOSAL

We suggest that the following modifications be made to the proposal for student loan reform offered by Representative Goodling:

1. Retain current law provisions with respect to interest rates and special allowances, but provide that the lender or holder of a loan rebate to the Secretary 20 basis points per annum on all new subsidized Stafford loans, regardless of loan status. This will result in cost savings comparable to the savings attributable to the interest rate reduction proposal included in the Goodling draft.

2. Reduce the lender origination fee from 100 to 50 basis points on all new loans made. Consolidation loans should be excluded from the fee, as provided in bracketed language provided in the Goodling draft amendment, to avoid the fee being paid twice on the same loan. This will reduce cost savings as scored for the Goodling proposal by 50 percent (from $910 million to $455 million).

3. Change the 25 basis point loan transfer fee into a 25 basis point conversion to repayment fee. This will have the effect of increasing cost savings.

4. Lender risk sharing should be coupled with the ability of lenders to use reasonable, commercial due diligence techniques rather than the rigid collection steps currently required in regulations. We believe that over time lenders will be successful in further reducing defaults because through risk sharing they will be economically motivated to utilize specially designed effective collection procedures.

5. Because strengthened lender of last resort provisions are crucial to maintaining continued loan access, origination fees should not be charged for loans made under a lender of last resort program, and such loans should be insured at 100%.

Total cost savings of the Goodling proposal, as we propose it be modified, would be at least $4.3 billion over 5 years, based on CBO's scoring of the original Goodling amendment. Language implementing these changes to the draft Goodling amendment is attached.

Revisions to Goodling Amendment

1. On page 21, strike line 10 through line 18 on page 22, and substitute the following:

"SEC. 4003. INTEREST REBATE TO THE SECRETARY

Add a new section 438(f) to the Act as follows:

(f) INTEREST REBATE TO THE SECRETARY.--Each lender shall pay to the Secretary an annual amount equal to 0.2 percent of the average principal amount outstanding on loans qualified for payment of interest by the Secretary under 428(a); provided however that such amount shall not be payable for loans made pursuant to section 428(j) or 439(q)."

2. On page 30, line 11 strike "1 percent" and insert in lieu thereof ".50" percent.

3. On page 24, strike line 12 through line 2 on page 25 and substitute the following:

"SEC. 4006. LOAN CONVERSION FEES

Section 428(b)(2) of the Act (20 U.S.C. 1078(b)(2)) is amended--

(1) by striking "and" at the end of subparagraph (E);

(2) by striking the period at the end of subparagraph (F) and inserting "; and"; and

(3) by adding at the end thereof the following new subparagraph:

"(G) provide that, with respect to subsidized and unsubsidized Stafford loans, a lender or holder shall pay to the Secretary a conversion fee in an amount equal to 0.25 percent of the principal amount of each loan at the time such loan enters repayment as defined in section 428(b)(7) of the Act."

4. On page 24, after line 2, insert the following:

"(3) LENDER DUE DILIGENCE.--Section 432 of the Act is amended by adding at the end thereof the following new subsection:

(q) In recognition of the provisions of section 428(b)(1)(G), the Secretary shall authorize lenders to use loan collection procedures reflecting prevailing commercial collection practices; provided however, the lender collection practices shall be designed by the lender to improve the likelihood of collection success."

5. On page 23, line 6, add, before the comma, the following: "and of loans made pursuant to sections 428(j) or 439(q)"

On page 24, line 2, add, before the period the following: "and of loans made pursuant to sections 428(j) or 439(q)"

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Direct Government Lending

vs.

Guarantees For Student Loans:

A Comparative Analysis

Dr. Rudolph G. Penner,
National Director for Economic Studies
KPMG Peat Marwick

COMMITTEE ON EDUCATION AND LABOR

U.S. HOUSE OF REPRESENTATIVES
2451 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

SUBCOMMITTEE ON POSTSECONDARY EDUCATION AND TRAINING

MEMORANDUM

May 7, 1993

TO: Members, Committee on Education and Labor

FROM: William D. Ford, Chairman

RE: Differences between Administration bill and Committee print

In order to clarify a number of ambiguities for the purposes of Congressional Budget Office scoring and to otherwise clarify the text, the following changes have been made to the Administration's transmitted bill:

- removed the July 1, 1998 ending date [Note: considering the past two reauthorizations of the Higher Education Act, the authority to make any loans may expire before the next reauthorization is signed into law. Also, to conform this provision with the current FFEL provision would require providing continued loan eligibility for current or former borrowers and only denying loan eligibility to new borrowers. It is simpler and consistent with other Federal entitlement programs to remove the ending date.]

- clarifies that any consortium of institutions is reimbursed for origination activities at the same rate as individual institutions

- allows the Secretary to impose additional criteria on institutional originators in order to protect the financial interest of the United States

- clarifies that all institutions in origination consortia must individually meet the origination criteria

- names Direct student loans as Federal Direct Student Loans and Federal Direct Unsubsidized Student Loans

- clarifies that borrower interest rates will be published in the Federal Register

- lowers the student origination fee to a flat 5 percent ?

- removes the first sentence in 455(d)(1), relating to the Federal cost of various repayment options - it was unenforceable and C.B.O. found it confusing

- clarifies that students will not be charged any additional amount or penalty if they choose to pay their loans off early

- clarifies that the minimum monthly payment of $50 will be in effect for both the standard and extended repayment options

- clarifies that the standard repayment option has the same terms and conditions as the current Stafford loans

- clarifies that if the Secretary gives a borrower an alternate repayment plan (pursuant to section 455(d)(4)), it will be at no additional cost to the Federal Government

- inserts cross-references to the tax code at the request of the Ways and Means Committee (Note: the Ways and Means Committee will mark-up the amendments to the Internal Revenue Code.)

- removes the forbearance language (this language applies to students who engage national services and it is already in the National Service bill)

- removes from the study of the future of Sallie Mae the assumption that Sallie Mae will be privatized.

- clarifies the study of I.R.S. involvement in collection of student loans to include more specific issues to be considered

- removes the authority of the Administration to involve the Internal Revenue Service in the collection of student loans without further Congressional action

- clarifies the computation in the Cost Sharing By States section

- makes other drafting changes because of the need for this proposal to be integrated into the overall reconciliation bill

May 29, 1993

Note for Bill Galston ✓
Gene Sperling

From: Barry White BW

Subj: Student aid and National Service

Belle asked me to send you each a copy of the attached re-write of the memo to the President. She would appreciate hearing from you by noon Tuesday, June 1. If you prefer to make your comments in writing or as edits on the text, please send them to me as well (FAX: 395-4875) to expedite production of the final version.

Significant items in this draft:

- Offsets are suggested for the spending options.
- Education has withdrawn its high option because it has already given so much in offsets for the negotiations on the 1994 appropriations.
- Eli Segal has provided language clarifying Kennedy's position, and extended language explaining his position, his view that a token amount in Campus-based programs only ($50 to $100 million) is adequate, and his concern that some decision be made the week of June 1 so that Kennedy can know where the Administration stands before the June 9th mark-up session.
- Education's views are expressed; they take into account the situation in the 1994 appropriation overall.

		BA
Work-study	fully restored	90
SEOG		85
SSIG		72
		$247

Kassebaum credit will pass

let Perkins go, although only $25 million

1. Admin
2. research & statistics
3. Program integrity
4. Pell overdraft

JTPA, Title 2A
(general block grant - but performance contracts)

DRAFT

MAY 29 1993

MEMORANDUM FOR THE PRESIDENT

FROM: LEON PANETTA

SUBJECT: Student aid, National Service and the 1994 Budget

ISSUE: Some in Congress, the higher education community, and the press are criticizing the Administration for funding National Service out of cuts in student aid. Although such tradeoffs in funding decisions between National Service and student aid did not occur, the perception of many critics is quite different. This perception could jeopardize the National Service initiative.

We requested substantial new funding for National Service, which is available to students without regard to their financial situations or needs; we reduced overall funding for student aid programs, which are based on financial need. Critics, therefore, say that the Administration supports aid for middle income students while reducing funding for financially needy students.

o In the 1994 Budget, the program level for Pell Grants would decline by $110 million between fiscal years 1993 and 1994; funding for campus-based aid would decline by $200 million.

This memo asks you to consider whether funding for the Pell Grant or campus-based aid programs should be increased in order to appease these critics, who are likely to oppose, or delay consideration of, National Service.

If you decide on any increase, it must, to be credible, be accompanied by offsets in addition to those we are already working with the appropriators to identify to meet the spending caps. Sources for offsets are suggested. They are primarily from Education, but finding all the offsets there for the most expensive option would exacerbate our problems with the education constituency. Specific offsets would have to be negotiated with the Appropriations Committees; items suggested illustrate what we would have to give up in the process.

BACKGROUND:

The Pell Grant program provides need-based grants to over 4 million undergraduate students, 78 percent of whom are from families with incomes under $20,000.

For the last three years, the appropriation has been insufficient to fully fund awards for all eligible students, leading to a cumulative shortfall of $2 billion. You recently approved funding the shortfall out of budget authority available under the FY 1994 caps. Although this action has been widely applauded in the education community, there are new signs that it will not satisfy many advocates. Specifically:

- o While continuing to advocate National Service, Senator Kennedy has expressed reservations to Eli Segal about pushing it aggressively at the same time that the Administration is perceived as reducing funding for financially needy students. Kennedy fears that Nancy Kassebaum might offer what could be an embarrassing amendment to the National Service authorization (scheduled for mark-up June 9), to require that no money be appropriated for National Service until the Administration asks for more resources for student aid.

- o A May 11 Washington Post editorial, entitled "What About Needy Students?" argues that the Administration has focused on college costs and loans for middle-class students, but has not adequately addressed the needs of lower-income students.

- o College presidents, particularly those from the large public schools, and higher education interest groups, such as the American Council on Education, are making similar charges.

Although the number of recipients would increase under your proposed Pell policy in all income classes, given current budget constraints, this could only be achieved by lowering average Pell awards for students in all income classes.

- o Lower average awards result from requiring of all students with family incomes over $5,000 a "minimum contribution" to their cost of education: $200 for dependent freshmen from families with incomes between $5,000 and $10,000, rising to $800 for independent students with incomes over $20,000.

Campus-based programs include college work-study, supplemental education opportunity grants, and Perkins loans. Each is a formula grant to schools, which then make the awards to students within broad Federal guidelines. Schools like these grants because they have greater flexibility on how much aid they give to which students than under Pell grant program's uniform national rules.

The $200 million cut (from $1.4 billion in 1993) was primarily for cost-savings, but also because the programs do overlap Pell grants and guaranteed student loans, which are better targeted and more uniformly administered.

OPTIONS AND OFFSETS FOR STUDENT AID BUDGET POLICY

Summary Table

		($ in millions) 1994 BA	1994 Outlays
Option 1:	Current policy	-0-	-0-
Option 2:	Campus-based only	+ 200	+ 20
Offsets:	Small ED programs	- 50	- 6
	Chapter 2	- 30	- 3
	Vocational Education	- 50	- 6
	Impact aid "b"	- 70	- 57
Option 3:	Pell only ($380m) increment:	+ 180	+ 56
Offsets:	Employment Service	- 100	- 20
	Dislocated worker assistance	- 80	- 4
		----	----
	MAXIMUM POLICY ADD-ONS:	380	76
	MAXIMUM OFFSETS:	380	96

Option 1: Add no new funds to student aid.

- PRO: The minimum contribution policy can fairly be described as consistent with your principles of personal responsibility and self help. In absolute terms, the amounts are small and clearly achievable by limited amounts of student work -- which most students do in any event. Almost any other policy would cost more money. The Campus-based policy also has a supportable rationale. Finding the necessary additional budgetary offsets is extremely difficult and will make some other groups equally unhappy.

- CON: The risk to 1994 funding for National Service is real and significant. This is one of your highest priorities. The damage to your Administration's goals from losing all or a large part of National Service should be avoided. One of the Options below could well accomplish this.

Option 2: Add $200 million to the Campus-based aid programs.

The $200 million Campus-based aid cut in the Budget could be restored (proportionately to each of the three programs, or split only between the two favorites of Senator Kennedy, the supplemental grants and work-study programs). Adding money to Pell Grants provides more aid to the poorer students, but adding money to Campus-based aid is more attractive to the private colleges, who are generally more supportive of National Service.

Eli Segal believes that as little as $50 to $100 million for Campus-based programs would solve the problem, but the Education Department disagrees.

<u>Offsets</u>:

- o $50 million from six small Education Department (ED) non-formula grant programs (each has congressional support and a constituency that would oppose the cuts, but the opposition would not be as important as the National Service problem);
- o $30 million from ED's Chapter 2 Elementary and Secondary Block Grant (liked by States but not well targeted; $385 million would remain);
- o $50 million from ED's Vocational Education Basic Grants (popular in Congress, but limited evidence of effectiveness; $917 million would remain);
- o $70 million from ED's Impact Aid "b"s (accelerates by one year the phase-out path already in the budget).

<u>Option 3</u>: <u>Add $380 million to Pell grants</u>.

The minimum student contribution requirement would phase in beginning at $15,000 instead of $5,000; contributions would be reduced for the poorer students. This would provide awards to about 16,000 more recipients than current policy and an average award about half way back to the 1993 level.

For about the same amount, we can raise the maximum award by $100 -- to $2,400 -- which is where it was in 1992. This would not raise average awards as much. The symbolism of raising the maximum award might outweigh the average award effects in the minds of the higher education community.

<u>Offsets</u>. In addition to those for option 2:

- o $100 million from DOL's Employment Service (a troubled program already the subject of intensive review by DOL and the NPR; $1 billion would remain);
- o $80 million from DOL's Dislocated Worker training request (total request: $1.7 billion; Congress will not provide the full amount in any event).

RECOMMENDATIONS

<u>The Education Department</u> will accept a decision to cut more of its programs in hopes of resolving the national service issue, if you decide that is necessary. However, Education has already been very forthcoming in volunteering offsets to OMB to help the appropriators fit the Budget into the discretionary spending caps. Education believes that cutting its programs still further explicitly to help National Service will be counterproductive: it may confirm the fears of the education community that funding for

National Service is a trade-off for education funding. This will hurt both Education and National Service. The education lobby will not be satisfied and will continue to make an issue of the National Service/Education trade-off.

Note that the House passed Second Supplemental bill (summer jobs, etc.) pays for non-Education activities in part by rescinding $72 million to terminate another student aid program (a year ahead of the Budget schedule), and $64 million more from other Education programs proposed in the Budget for 1994 termination. Sensitivity to cuts in Education to pay for non-education priorities is, therefore, already running high.

Eli Segal's perspective is premised primarily on timing issues. Since we want the National Service program in place for FY 1994, we need the authorization passed in time for funds to be appropriated in the FY 1994 appropriation act. The House and Senate will mark up National Service June 9; the House is prepared for floor debate perhaps as early as June 15. Scheduling debate in the Senate in June (for passage in early July) would be facilitated by moderate increases in student aid funding.

Eli, therefore, eager for a big Administration win as soon as possible, recommends that additional funds for Campus-based aid -- certainly less than $200 million -- be made available. He believes that there is no political need to go any further on Pell grants than our plans to fund the shortfall. He cautions, however, that when we are looking at offsets, we should be as conscious of Bill Ford's perspective on where they come from as Senator Kennedy's. He concludes that regardless of whether funds are or are not found, we should move quickly to advise Senator Kennedy. Failure to find funds may be a problem for 1994, but failure to tell Kennedy our plans as soon as possible will be an unnecessary complication.

OMB recommends ...

DECISION:

_____ Option 1: Add no new funds to student aid.

_____ Option 2: Add $200 million to Campus-based.

_____ Option 3: Add $380 million to Pell.

_____ Other:

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Reinventing the Federal Student Loan Program

A proposal to ensure the stability of the federal student loan program, improve service to students and save taxpayers money

Bill Gaston

CSLR

Coalition for Student Loan Reform

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Let's Take Back Student Aid:

Direct Lending Issues and Myths

Advisory Committee on Student Financial Assistance

May 3, 1993

The Honorable William Galston
Deputy Assistant to the President
for Domestic Policy
The White House
Washington, D.C. 20500

Dear Mr. Galston:

When Congress enacted the Education Amendments of 1992, it charged the Advisory Committee on Student Financial Assistance to conduct a student loan simplification study and deliver a final report with recommendations this July. In light of the current debate between proponents of retaining the existing programs and those calling for a move to a new direct lending program, our members feel strongly that this interim report is required so that our findings to date may be used in your deliberations this spring.

Committee analysis of information from three hearings, one meeting, and a national symposium shows conclusively that both the structure and operation of the current loan programs are needlessly complex and require major reform. While our Committee remains neutral on the issue of direct lending, we are unanimous in the conclusion that the vigorous debate offers a unique opportunity to simplify the loan programs. It is therefore critical that Congress use the opportunity to force changes in the current programs or move to a streamlined version of direct lending. Either course of action will benefit students and institutions greatly; inaction will send a signal to the community that business as usual will prevail in the loan programs for the rest of the decade.

Perhaps our most important finding is that either loan program must be fully integrated with the delivery of the Pell and Campus-based programs. Separate applications, processes, procedures and data bases are not necessary and undermine the goals of the student aid programs by overburdening students and institutions. Integration will not happen voluntarily--in either program--and must be required by Congress and implemented by the Secretary.

If Congress decides to reform the existing programs, we recommend a radical restructuring through creation of a single program, reduction in the number of participants, and standardization of loan interest rates and terms and conditions. If, on the other hand, Congress decides to move to a new direct lending program, it is essential that it be kept

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simple with standard terms and conditions; and, most important, that the terms of a student's new loans not depend in any way on past loans. Failure to keep new and old loans independent will visit on a direct lending program much of the complexity that needs to be eliminated from current programs. The Committee's final report including a full set of recommendations and a comparison of the two programs requested by Senator Pell will be delivered in July. Please direct any questions or requests for assistance to our Staff Director, Brian Fitzgerald.

On behalf of each of our members, I would like to thank both Congress and the Secretary for the opportunity to present these recommendations. As always, our Committee and staff are anxious to provide whatever technical assistance we can to your efforts.

Sincerely,

Lynn M Burns

Lynn M. Burns
Chairperson

Enclosure

THE WHITE HOUSE
WASHINGTON

DATE: 7/3/93

TO: BILL GALSTON

FROM: JOHN D. PODESTA
Assistant to the President and
Staff Secretary

For your information.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 93 JUL 1 P5:50

SECRETARY OF THE TREASURY

June 30, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: Lloyd Bentsen LMB

SUBJECT: Report on the Student Loan Marketing Association

The Higher Education Act of 1965, as amended, requires the Secretary of the Treasury to report the completion of the annual audit of the Student Loan Marketing Association (Sallie Mae) accounts to the President and to Congress. Sallie Mae is a stockholder-owned corporation created by Congress in 1972 as a secondary market for federally guaranteed student loans.

The attached Sallie Mae Annual Report includes financial statements for the year ended December 31, 1992, and an unqualified opinion by the certified public accounting firm of Ernst & Young. Net income after taxes for the year ended December 31, 1992, amounted to $394 million, compared with $345 million for the year ended December 31, 1991, or an increase of 14 percent. Total assets and total liabilities each showed an increase of 3 percent, to $47 billion and $45 billion, respectively. Sallie Mae's retained earnings at December 31, 1992, amounted to $1.753 billion, up from $1.465 billion at the end of the previous year. Sallie Mae's financial obligations are not obligations of the Federal Government. Sallie Mae, however, receives U.S. Government monies representing insurance proceeds on defaulted student loans. Sallie Mae's average student loan portfolio amounted to $22.941 billion and $20.694 billion for 1992 and 1991, respectively. During 1992, Sallie Mae received claims proceeds totaling $1.02 billion, compared with $1.2 billion the previous year. Thus, insurance proceeds represented 4.5 percent and 5.8 percent of Sallie Mae's average student loan portfolios for 1992 and 1991, respectively. Borrower defaults numbered 319,000 in 1992 and 382,000 in 1991.

The Higher Education Amendments of 1992 established capital requirements for Sallie Mae and gave the U.S. Department of the Treasury authority to monitor Sallie Mae's financial condition. At December 31, 1992, Sallie Mae's capital ratio was 2.53 percent, compared with an established minimum of 2 percent. As required by the Higher Education Act, this report is also being submitted to Congress. Also, a copy is being sent to the Secretary of Education, and to the Student Loan Marketing Association.

Attachment: Sallie Mae Annual Report

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BARRY WONG, HIGH SCHOOL TEACHER

AS A SECONDARY MARKET,

SALLIE MAE COUNTS ITS BANK CLIENTS

IN THE HUNDREDS, AND ITS SCHOOL

CONSTITUENTS IN THE THOUSANDS —

BUT...

ITS ULTIMATE CUSTOMERS,

EDUCATION LOAN BORROWERS,

NUMBER IN THE MILLIONS.

MESSIAH COLLEGE BS BIOLOGY, 1991

STUDENT LOAN INTEREST DEDUCTION RESTORATION COALITION

1625 Massachusetts Avenue, N.W. Washington, D.C. 20036
202-667-9433 FAX- 202-667-0642

April 7, 1993

William A. Galston
Domestic Policy Council
Executive Office of the President
The White House, West Wing, 2nd Floor
Washington, DC 20500

Dear Mr. Galston:

As a follow-up to your recent conversation with Ms. Becky Halkias of Murray, Scheer, and Montgomery, I am writing to request a meeting between your office and the Student Loan Interest Deduction Restoration Coalition, and to provide background materials on this issue. Our group consists of 30 national organizations concerned with student loan debt, and we believe this issue is consistent with the Administration's goals for supporting the nation's investment in education.

This concept has received widespread bi-partisan support, as various forms of this legislation were part of the Bush Administration's FY 1993 budget proposal, the House tax bill (H.R. 4210) passed in February, 1992, the Senate version of that bill, and the Conference tax bill that was vetoed by President Bush in March, 1992. Additionally, the bill has received as many as 330 co-sponsors in the House of Representatives in the past. Just recently, restoration of this benefit was recommended by the National Commission for Financing Postsecondary Education in its report "Making College Affordable".

We are concerned that since the Clinton Administration did not include this proposal in its initial economic stimulus and tax package, students in the country will hear the wrong message that the Administration is not willing to address an issue of direct, immediate benefit to many students and recent graduates. The proposals our coalition is endorsing are consistent with and complimentary to the Administration's efforts in designing a National Service plan. Therefore, we would like the opportunity to directly discuss the current proposed legislation, S. 271, and H.R. 1667, that we urge the Administration to support.

Attached to this letter is a list of coalition groups, a fact sheet, a summary of 1992 legislation, and a copy of S. 271 along with a background statement. Also attached is an earlier meeting request letter we sent to Ms. Doris Matsui in the White Office of Public Liaison. We have not yet received a response. However, we did recently meet with Mr. Matthew Gorman, in the Department of Treasury Office of Business Liaison, who expressed support for this issue and urged us to contact your office. We also provided materials to Mr. Jose Berra in the Department's Tax Policy office. Please call me at 202-667-9433 if you have any questions about this letter.

Sincerely yours,

Scott Litch

Scott Litch, Coalition Coordinator
Legislative Counsel
American Association of Dental Schools

Attachments

STUDENT LOAN INTEREST DEDUCTION RESTORATION COALITION

1625 Massachusetts Avenue, N.W. Washington, D.C. 20036
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Student Loan Interest Deduction Restoration Coalition
Member Organizations
as of 3/93

Academy of General Dentistry
American Association of Colleges of Nursing
American Association of Colleges of Osteopathic Medicine
American Association of Colleges of Osteopathic Medicine-
Council of Student Council Presidents
American Association of Colleges of Pharmacy
American Association of Colleges of Podiatric Medicine
American Association of Dental Schools
American Association of University Professors
American Bar Association- Section of Legal Education and Admission to the Bar
American Council on Education
American Dental Association
American Medical Student Association
American Medical Women's Association
American Osteopathic Association
American Podiatric Medical Association
American Podiatric Medical Students Association
American Student Assistance
American Student Dental Association
American University of Beirut
Association of American Law Schools
Association of American Medical Colleges
Association of American Veterinary Medical Colleges
Association of Jesuit Colleges and Universities
Committee on Interns and Residents
Education Funding Services, Inc.
Law School Admission Council
National Association of Advisors for the Health Professions
National Association of Graduate and Professional Students
Student Osteopathic Medical Association
United States Student Association

Coalition contact: Scott Litch, AADS (at above number and address)

STUDENT LOAN INTEREST DEDUCTION RESTORATION COALITION

1993 FACT SHEET

Background- The 1986 Tax Reform Act eliminated the deduction for "consumer" interest (under a five year phase-out) to discourage over-reliance on credit. Unfortunately, educational loans were also included, despite the fact that they are an investment in education rather than discretionary consumer borrowing. Further, the existing home equity loan deduction is not an adequate substitute, since most of the student population, and some families, do not own a home and cannot benefit from this deduction. Elimination of this deduction especially hurts those students who come from families where there is little or no excess cash to contribute to the student's education, as well as students who are financially independent and not receiving parental support for pursuing a degree. For many, a loan is the only means to finance a higher education.

The Current Problem- In recent years there has been increasing reliance on loans to finance a higher education, as fewer grants and scholarships are available. Most students have been willing to incur this debt because they see it as an investment in their future financial security and in their potential for social contribution. Loans have dramatically increased from 39% of all federal student aid 20 years ago to 65% in 1990. This has led to high indebtedness for many students. Average graduating debt for undergraduates at public four programs is over $6500, and is over $9500 at private four year programs. Debt is growing for graduate students due to fewer fellowships and stipends; 50% of all 1991 black and hispanic doctoral recipients in the social sciences had over $10,000 debt. Average graduating debt for medical and dental students is approximately $50,000, and debts of over $100,000 are not unusual. Such debt is a significant burden in the years immediately after graduation. The growing debt burden for students may discourage entry into higher education and the pursuit of additional degrees, especially for disadvantaged and minority students and those considering professional and graduate degrees. Such debt may also discourage graduates from taking lower-paying public service, teaching, and research positions. Health professions graduates with high debt may be deterred from careers in primary care. A medical graduate working as a primary care provider with educational debt of $75,000 at an interest rate of 11% would likely face monthly interest payments of over $700 and first year interest of over $8000. Their loan payments would probably exceed 20% of income in the first few years after graduation.

A Legislative Solution- <u>SLIDRC supports legislation to provide taxpayers with student loan debt a choice between a deduction or a credit for student loan interest in the initial years of loan repayment. Such a bill was introduced by Senators Boren and Grassley on February 2, 1993 (S. 271) and by Representatives Cardin and Bunning on April 2, 1993 (H.R. 1667).</u> Restoring this deduction would support and encourage investment in higher education. Various forms of this legislation were part of a House, Senate, and Conference tax bill (vetoed) in 1992.

Justification- The interest deduction is especially important for heavily indebted students in the first years after graduation when earnings are low and interest makes up a greater portion of loan repayment. While not the only solution to the growing debt problem, nor the only factor affecting career choices, a student loan interest deduction will be of significant financial help in making loan repayment more reasonable and allowing the graduate his or her full consideration of career options. Further, the deduction/credit idea targets relief to those with higher debt because it is proportional to debt load. A tax credit option means that all with higher education debt would be assisted, not just those who itemize. By restoring the student loan interest deduction, the government acknowledges not only the costs incurred in making this investment, but the contribution higher education makes to society at large. In times when technologic and scientific training is critical to our world competitiveness, the need to invest in higher education becomes even more important to the economic future of our country. This is the type of middle and lower income tax relief that encourages investment in our most important resource: people.

Cost- In the 102nd Congress, the Joint Committee on Taxation estimated the revenue loss of H.R. 747 at $300 million over 5 years. The revenue estimate for S. 2160 (the 1992 Boren-Grassley proposal) was approximately $800 million over 5 years. Valid limitations made this proposal much cheaper than the 1992 Bush Administration proposal (restore deduction for all student loan interest repayments after 7/92 without restrictions) estimated at $3.6 billion over 5 years.

STUDENT LOAN INTEREST DEDUCTION RESTORATION COALITION

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Summary of 1992 Student Loan Interest Deduction Proposals and Outcome

January - March 1992

Administration Proposal: Restore student loan interest deduction for all loan repayments made on or after July 1, 1992, with no income or time limitation. This would cover those currently in repayment. Estimated cost- $3.6 billion over 5 years

House Action: On February 27 the House of Representatives approved tax legislation that included a higher education loan tax credit proposal. Estimated cost- $400 million over 5 years.

> This would provide a tax credit equal to 15% of higher education loan interest, but the total credit could not exceed $300 per year (it would increase to $500 per year for those whose annual interest exceeds 10% of AGI). Independent students would get the benefit for the first 5 years (whether or not consecutive) they are not at least a half-time student. Parents would get the benefit for the period their child is at least a half-time student, and the cap is applied separately to interest paid for each child in school. The credit would be phased out for independent students between $30,000-55,000 Adjusted Gross Income (AGI) for individual returns, and $50,000-75,000 for joint returns. Parent phase-out ranges would be $45,000-70,000 individual, $75,000-100,000 joint. Credit would take effect for interest paid after December 31, 1991, which would cover loans borrowed before that date.

<u>SLIDRC Analysis and Position:</u> Advocated for H.R. 747, S. 2160, or the Administration's proposal, all of which included a deduction provision. The Ways and Means Committee recognized the need for a student loan benefit, but a credit-only provision without a deduction option is a relatively flat benefit, and not as useful for high debt graduates as an interest deduction. For example, an independent student with $100,000 debt and $40,000 AGI would receive a $300 tax savings from the House provision, but would save at least $2100 in taxes from an interest deduction. Also, independent students were not treated as well as parents under the House provision, due to differences in income caps and the "per child" credit allowance for parents. In light of this outcome, SLIDRC advocated S. 2160 for adoption in the Senate.

Senate Action: On March 13 the Senate approved tax legislation that included S. 2160, the Boren-Grassley student loan interest deduction/credit proposal (this combined features of H.R. 747 and the House credit proposal). Estimated cost- $800 million over 5 years.

> This would provide taxpayers with a choice of a full interest deduction, or a credit (capped at $300) for those who don't itemize. The benefit would generally extend for the first 4 years of repayment. There would be no income limitations. It would apply to all those entering repayment after December 31, 1991.

SLIDRC position for Conference: Supported the Senate deduction/credit provision.

Conference: On March 20, Congress approved a Conference bill (H.R. 4210) on tax legislation (50-44 in the Senate and 211-189 in the House) which was promptly vetoed by the President due to tax increases for higher income individuals included in bill. The final student loan interest provision in the Conference tax bill was a credit-only benefit:

- Taxpayer who borrows for higher education expenses would receive a tax credit equal to 25% of annual student loan interest, capped at $400 annually (note: for parents this cap would apply separately to each child who is a student, as in the House bill);
- The credit benefit would be phased out between $40,000-65,000 AGI for individuals, and $60,000-85,000 AGI for joint returns;
- The credit would be allowed for interest paid that is allocable to the first 48 months that interest accrued on the loan;
- The estimated revenue loss was $479 million over 5 years;
- It would apply to those entering repayment after December 31, 1991.

SLIDRC Analysis and Position: Conferee concern with revenue loss led to adoption of a credit-only provision with income caps. The SLIDRC position was that the Senate student loan interest deduction option would be more beneficial for high debt borrowers, and thus more proportionately targeted based on need. In cases of high debt, tax savings from a deduction would be much greater than $400. Also of concern was the limitation to the first 48 months of accrued interest, since under some loan programs interest accrues during the in-school period and may be added to loan principal, even though repayment by the borrower does not begin until later when schooling is completed.

While the credit provision was less than the coalition had advocated, it had significance as the **first student loan interest tax provision that cleared Congress since the phase-out of the student loan interest deduction in the 1986 Tax Reform Act**. Also, the discrepancy in income limits between parents and independents students, as was provided in the original House credit provision, was eliminated in the final bill.

Aftermath- April - October, 1992

* **SLIDRC**- The Coalition continued with the message that restoration of a student loan interest deduction is a non-controversial, bi-partisan issue, and that a deduction or credit option is the best legislation. SLIDRC continued to work with university representatives, developed a strategy committee in D.C., responded to a study by the Congressional Research Service, and investigated revenue offset ideas. SLIDRC also worked on a revised bill including technical corrections.

* **Congress**- In July, Congressman Schulze (R-PA) failed in an attempts to approve SLID in a Ways and Means mark-up, due to the lack of an acceptable revenue offset. The urban enterprise zone tax bill moved ahead in the Senate Finance Committee on July 28, but Senators Boren and Grassley were not successful in including the deduction/credit provision in this package. The conference tax bill (H.R. 11) cleared Congress but was vetoed by the President on November 4, 1992. This means that no major tax legislation became law in 1992.

1993 Outlook - The best hope for success would be a renewed effort to pass a 1993 middle income tax relief bill, and inclusion of the deduction/credit provision in such a bill.

103D CONGRESS
1ST SESSION

S. 271

To amend the Internal Revenue Code of 1986 to allow a credit for interest paid on education loans.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 2 (legislative day, JANUARY 5), 1993

Mr. GRASSLEY (for himself, Mr. BOREN, Mr. DANFORTH, Mr. DASCHLE, and Mr. SIMON) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1986 to allow a credit for interest paid on education loans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CREDIT FOR INTEREST ON EDUCATION LOANS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to nonrefundable personal credits) is amended by inserting after section 22 the following new section:

"SEC. 23. INTEREST ON EDUCATION LOANS.

"(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 15 percent of the interest paid by the taxpayer during the taxable year on any qualified education loan.

"(b) MAXIMUM CREDIT.—The credit allowed by subsection (a) for the taxable year shall not exceed $300.

"(c) LIMITATION ON TAXPAYERS ELIGIBLE FOR CREDIT.—No credit shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual's taxable year begins.

"(d) LIMIT ON PERIOD CREDIT ALLOWED.—

"(1) TAXPAYER AND TAXPAYER'S SPOUSE.—Except as provided in paragraph (2), a credit shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 48 months (whether or not consecutive) in which interest payments are required. For purposes of this paragraph, any loan and all refinancings of such loan shall be treated as 1 loan.

"(2) DEPENDENT.—If the qualified education loan was used to pay education expenses of an individual other than the taxpayer or the taxpayer's spouse, a credit shall be allowed under this section for any taxable year with respect to such loan only if—

"(A) a deduction under section 151 with respect to such individual is allowed to the taxpayer for such taxable year, and

"(B) such individual is at least a half-time student with respect to such taxable year.

"(e) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EDUCATION LOAN.—The term 'qualified education loan' means any indebtedness incurred to pay qualified higher education expenses—

"(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer,

"(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

"(C) which are attributable to education furnished during a period during which the recipient was at least a half-time student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term 'qualified education loan' shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

"(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The term 'qualified higher education expenses' means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of this Act) of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution. For purposes of the preceding sentence, the term 'eligible educational institution' has the same meaning given such term by section 135(c)(3), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

"(3) HALF-TIME STUDENT.—The term 'half-time student' means any individual who would be a student as defined in section 151(c)(4) if 'half-time' were substituted for 'full-time' each place it appears in such section.

"(4) DEPENDENT.—The term 'dependent' has the meaning given such term by section 152.

"(f) SPECIAL RULES.—

"(1) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any amount for which a deduction is allowable under any other provision of this chapter.

"(2) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703."

(b) OPTIONAL DEDUCTION FOR INTEREST ON EDUCATION LOANS.—Paragraph (2) of section 163(h) of the Internal Revenue Code of 1986 (defining personal interest) is amended by striking "and" at the end of subparagraph (D), by redesignating subparagraph (E) as subparagraph (F), and by inserting after subparagraph (D) the following new subparagraph:

"(E) any interest paid on a qualified education loan (as defined in section 23(e)) during the period described in section 23(d), unless a credit or deduction is taken with respect to such interest under any other provisions of this chapter, and".

(c) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 22 the following new item:

"Sec. 23. Interest on education loans."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 23(e) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after July 1, 1993, but only with respect to any loan interest payment due after June 30, 1993, and before the termination of the period described in section 23(d)(1) of such Code.

U.S. companies can secure market position, improve their knowledge of the business environment, and increase trade.

Japan's trade surplus has been a source of friction with its trading partners. Ensuring better access to the large and lucrative Japanese market is a constructive way to reduce this friction, and ultimately in Japan's best interest. To this end, this report addresses specific issues inhibiting market access by American firms from a wide range of industries in the hope that increased awareness will bring about their timely elimination.

While pressing for resolution of the issues outlined in this document, the ACCJ will continue to urge the United States Government—both its legislative and executive branches—to refrain from enacting protectionist measures.

The ACCJ is confident that the commitment and well-intentioned efforts of its member-companies, working with U.S. and Japanese business leaders and government officials, can achieve mutually beneficial agreements to improve the ability of foreign firms to do business in Japan. No lesser goal is in the interest of either the United States or Japan.

By Mr. GRASSLEY (for himself, Mr. BOREN, Mr. DANFORTH, Mr. DASCHLE, and Mr. SIMON):

S. 271. A bill to amend the Internal Revenue Code of 1986 to allow a credit for interest paid on education loans; to the Committee on Finance. or deduction

HIGHER EDUCATION TAX BENEFITS ACT OF 1993

• Mr. GRASSLEY. Mr. President, I am being joined today by Senator BOREN and others in reintroducing legislation to restore tax benefits for interest paid on student loans.

Today, there is no greater issue of concern to the American people than the economic problems our Nation is facing. As we look into ways to improve our economy, we have to keep in mind the importance of addressing our Nation's long-term needs by including a restoration of tax benefits for higher education.

We all know that under the Tax Reform Act of 1986, the consumer interest deduction was phased out after the 1990 tax year. Unfortunately, educational expenses were lumped together with consumer interest and the deduction for student loan interest was also terminated. By taking this action, Congress effectively imposed an additional tax on individuals who are attempting to better themselves or their families through higher education.

Congress justified repealing the interest deduction on the grounds that it was a significant disincentive to saving. However, unlike loans for most other personal items, student loans have become a necessity for many students and their families who are unable to afford the rising costs of an education.

In addition, consumer interest, up to a limit, remains deductible if the loan is secured by a taxpayer's residence. Even if this home equity loan is used for educational expenses, the interest is deductible. Consequently, current law discriminates against middle and lower income taxpayers who are not fortunate enough to own a home and borrow on the home's equity.

With this in mind, I have introduced legislation since 1987 to restore the interest deduction on student loans. Working together, Senator BOREN and I put together legislation last year that would have provided tax benefits for higher education where taxpayers could choose between a tax credit or deduction, depending on their needs. We were successful in getting a version of our legislation included as part of the Senate version of H.R. 4210, which passed the Congress. However, although President Bush supported our legislation, he vetoed H.R. 4210. So, we're back again this year, and hopefully President Clinton will support our cause.

Under our legislation, both itemizers and nonitemizers will be eligible for benefits. In the past, only itemizers were able to qualify for a benefit, so many more people will be helped under our bill. In an effort to bring down the cost, the credit or deduction will be limited to 4 years of a loan's payback term. This is a period when interest payments are the greatest and taxpayers are less able to afford the cost of the loan.

Mr. President, the current law precluding interest deductions or credits for higher education is neither fair nor productive, and it's time to make an adjustment. We all agree that education is a national investment which will be a determining factor in the future of America. A well-educated work force is vitally important if we are to compete effectively in the international marketplace. Restoring tax benefits for interest paid on student loans is an expression of the value we place on education and its role in maintaining the position of the United States as the leader of our post-cold-war world.

I urge my colleagues to join me and the cosponsors of this legislation once again in supporting the education and future of America by adjusting the Tax Code to provide assistance to Americans for reasonable educational expenses.

I ask unanimous consent that the bill be printed following my remarks.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S. 271

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CREDIT FOR INTEREST ON EDUCATION LOANS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to nonrefundable personal credits) is amended by inserting after section 22 the following new section:

"SEC. 22. INTEREST ON EDUCATION LOANS.

"(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 15 percent of the interest paid by the taxpayer during the taxable year on any qualified education loan.

"(b) MAXIMUM CREDIT.—The credit allowed by subsection (a) for the taxable year shall not exceed $300.

"(c) LIMITATION ON TAXPAYERS ELIGIBLE FOR CREDIT.—No credit shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual's taxable year begins.

"(d) LIMIT ON PERIOD CREDIT ALLOWED.—

"(1) TAXPAYER AND TAXPAYER'S SPOUSE.—Except as provided in paragraph (2), a credit shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 48 months (whether or not consecutive) in which interest payments are required. For purposes of this paragraph, any land and all refinancings of such loan shall be treated as 1 loan.

"(2) DEPENDENT.—If the qualified education loan was used to pay education expenses of an individual other than the taxpayer or the taxpayer's spouse, a credit shall be allowed under this section for any taxable year with respect to such loan only if—

"(A) a deduction under section 151 with respect to such individual is allowed to the taxpayer for such taxable year, and

"(B) such individual is at least a half-time student with respect to such taxable year.

"(e) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EDUCATION LOAN.—The term 'qualified education loan' means any indebtedness incurred to pay qualified higher education expenses—

"(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer,

"(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

"(C) which are attributable to education furnished during a period during which the recipient was at least a half-time student.

Such term includes indebtedness used to refinance indebtedness which qualified as a qualified education loan. The term 'qualified education loan' shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

"(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The term 'qualified higher education expenses' means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of this Act) of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution. For purposes of the preceding sentence, the term 'eligible educational institution' has the same meaning given such term by section 135(c)(3), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

"(3) HALF-TIME STUDENT.—The term 'half-time student' means any individual who would be a student as defined in section 151(c)(4) if 'half-time' were substituted for 'full-time' each place it appears in such section.

"(4) DEPENDENT.—The term 'dependent' has the meaning given such term by section 152.

"(f) SPECIAL RULES.—

"(1) DENIAL OF DOUBLE BENEFITS.—No credit shall be allowed under this section for any amount for which a deduction is allowable under any other provision of this chapter.

OVER

"(2) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703."

(b) OPTIONAL DEDUCTION FOR INTEREST ON EDUCATION LOANS.—Paragraph (2) of section 163(h) of the Internal Revenue Code of 1986 (defining personal interest) is amended by striking "and" at the end of subparagraph (D), by redesignating subparagraph (E) as subparagraph (F), and by inserting after subparagraph (D) the following new subparagraph:

"(E) any interest paid on a qualified education loan (as defined in section 23(e)) during the period described in section 23(d), unless a credit or deduction is taken with respect to such interest under any other provisions of this chapter, and".

(c) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 22 the following new item:

"Sec. 23. Interest on education loans."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 23(e) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after July 1, 1993, but only with respect to any loan interest payment due after June 30, 1993, and before the termination of the period described in section 23(d)(1) of such Code.

Mr. BOREN. Mr. President, I am pleased to join with my colleague, Mr. GRASSLEY, and others in introducing again our bill that would allow taxpayers the ability to elect either a deduction or a tax credit for the interest paid on loans used to finance the costs of higher education. I think this legislation is important because it represents real relief for middle-income Americans and because it encourages investment in the most important resource of our country—an educated work force.

The new administration is committed to providing economic relief to our Nation's middle-income families; we are now searching for a way to provide meaningful relief within tight budgetary constraints. One of the greatest struggles facing middle-income families is the skyrocketing cost of providing a college education for their children. The very wealthy have little trouble finding the money to educate their children; on the other hand, many scholarships and grants are available only for the poor. Those in the middle, however, earn just enough so that their children cannot qualify for benefits; yet they don't earn enough to afford to send their children to college.

The statistics reveal the dilemma faced by middle-income families with teenaged children. While middle-income children make up three-fourths of the college-age population, they receive only about 4 percent of student aid and scholarships. One reason for this absence of grants and scholarships is that fewer are available in these times of shrinking Government resources. Loans have dramatically increased from 39 percent of all Federal aid 20 years ago to 65 percent in 1990.

Middle-income Americans have no choice but to take out large educational loans. Although the average cost of going to college ranges between $6,000 and $22,000 per year, the average middle-income family has only about $60,000 in net worth, most of it in home equities. This reality has led to high indebtedness for many students and their families. Average graduating debt for undergraduates at public 4-year programs is over $6,500, and over $9,500 at private 4-year programs. Average graduating debt for medical and dental students is over $50,000, and debt of over $100,000 for students graduating from professional schools are not unusual.

This statistical truth was forcefully brought home to me last year during the testimony of a middle-income mother of college-age sons before the Finance Committee. She spoke of the painful reality her family faced when they confronted the financial burden of sending her oldest son to university. They could not qualify for need-based scholarships or grants. If they had not taken out substantial loans and the mother had not returned to work, they would have been forced to sell their home to pay for higher education at an institution chosen in part because of its lower tuition.

This is not the story of only one mother, one family. It is the story of middle-income parents in every part of this country. Moreover, the enormous debtload carried by graduating students continues to affect their decisions even after they leave school. Many who face substantial interest payments may be discouraged from pursuing additional degrees; others feel they cannot consider careers in public service, teaching, or research because these jobs, while important to our society and rewarding, do not command sufficiently high salaries.

Mr. President, this is more than an issue of short-term relief for the middle-income taxpayer. A highly educated work force is crucial to this country's economic growth and its ability to compete in the international marketplace. We simply cannot afford to deny a generation of middle-income Americans the opportunity to contribute to this country's future, equipped with the best education available.

The bill that we introduce today addresses these problems. It offers real middle-income relief at an affordable price tag; the Joint Committee on Taxation estimated last year that similar legislation would result in a revenue loss of only $800 million over 5 years. The relief is limited to the first 4 years of loan repayment because this is the period in a student's life when earnings are low and interest makes up a greater portion of loan repayment. Moverover, by providing the option of a tax credit, the relief is available for taxpayers who do not itemize.

A similar student loan interest provision was included in H.R. 4210, the comprehensive middle-income tax relief bill that was vetoed last year. It is my hope that the provision will be enacted this year as part of the new administration's middle-income relief and economic growth package. No proposal for either middle-income tax relief or economic stimulation is complete unless it contains some provision to lessen the tremendous burden on financing higher education for middle-income Americans. I look forward to working with the administration and my colleagues in the Congress to enact this legislation.•

By Mr. DECONCINI:

S. 272. A bill to extend the temporary suspension of import duties on cantaloupes; to the Committee on Finance.

CANTALOUPE DUTY ACT OF 1993

• Mr. DECONCINI. Mr. President, today I am reintroducing legislation to extend the temporary suspension of import duties on cantaloupes during the winter months when they are unavailable from domestic sources. This legislation is identical to that recently introduced by Chairman DE LA GARZA of the House Agriculture Committee.

During the warmer months, cantaloupes are grown widely in the United States. By October and November, however, availability narrows and only small shipments are available to U.S. consumers from Arizona, Texas, California, and Georgia. Between the winter months of December through April there is no commercial production of cantaloupes in the United States. Even the temperate climate of Arizona is not warm enough to grow cantaloupes during that time. Therefore, the American consumer must turn to foreign sources.

Consumers today demand a variety of fresh fruits and vegetables throughout the year. Suspending the duty on cantaloupes in the winter months not only has no adverse affect on domestic agriculture, but positively aids American farmers. It is not beneficial to domestic producers to have consumers associate fruits and vegetables to various times of the year as sales do not reach their peak until the height of the season. Providing nondomestic supplies, so that fruits and vegetables are available throughout the year, enables a smooth transition to the domestic supply after the winter season.

The major winter producers of cantaloupes include Mexico, Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, and Panama. While Arizona, Texas, and California are the major producers of cantaloupes in the summer, Mexico is a major supplier in the winter. Much of the cantaloupes from Mexico are shipped into the United States through Arizona and Texas.

The duty suspension achieved by this bill would not be new. Both Chairman DE LA GARZA's bill and my own would extend for 2 years the duty suspension which expired on December 31, 1992. The widespread benefits of the duty suspension would go to shippers, distributors, truck drivers and food store workers, and to American consumers who will be assured reasonably-priced

Restoration of a student loan interest deduction/credit would be an important step to improve this situation. While it is not the only solution, it should be part of an overall strategy to support the investment in people. We believe that this would complement other efforts to reform student loan programs, such as a national service corps/loan forgiveness approach. However, given the limited numbers that can be helped through a service program due to budget constraints, the deduction/credit will help many more students right away while encouraging their entry into public service jobs. Regardless of what the borrowing program may look like in the future, we think it is essential for tax policy to recognize that higher education borrowing is an important investment in our nation's future.

The coalition has been willing to be flexible with the legislative approach. However, we believe that a deduction/credit option is better for students and families. It allows non-itemizers to benefit from a credit, while the deduction option proportionately targets the benefit to those with significant student loan burdens. In light of budget constraints, we are also aware of the need to target the measure. Since the goal is to help low and middle income students with high debt in the first few years after graduation, particularly to encourage them to enter public service, teaching, and research, we have been willing to support limiting the benefit to the first four years of loan repayment (as provided in S. 271).

Attached to this letter is a fact sheet on the issue, a list of organizations in our coalition, and a list of Ways and Means Committee member co-sponsors in the 102nd Congress. Please contact Mr. Litch at 202-667-9433 if you need further information. Thank you for considering this request.

Sincerely yours,

Barbara Brookmyer

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Legislative Affairs Director
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STUDENT LOAN INTEREST DEDUCTION RESTORATION COALITION

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March 5, 1993

Ms. Doris Matsui
Deputy Assistant to the President and Deputy Director of Public Liaison
128 Old Executive Office Building
17th Street and Pennsylvania Avenue NW
Washington, DC 20500

Dear Ms. Matsui:

We are writing on behalf of the Student Loan Interest Deduction Restoration Coalition (SLIDRC), which currently consists of 30 higher education and health organizations. The coalition was formed in 1989 to encourage the correction of what we believe is an error in how the tax code treats student loan interest payments. This benefit was phased out in the 1986 Tax Reform Act. We met with Ms. Gloria Cabe of the transition team in December and provided detailed materials on this issue. However, we are concerned that this issue was not included in the President's economic growth package, and urge the Administration to take a closer look at how this bi-partisan issue can complement the plans for a national service corps.

We would like to request a meeting between members of our coalition and your office, or the appropriate staff at the Department of Treasury, to discuss this issue. Specifically, we are supporting the concept that a taxpayer can choose between either a student loan interest deduction or credit. Such legislation has been introduced in the Senate (S. 271) by Senators Boren and Grassley, and is expected to be introduced shortly in the House. This concept has received widespread bi-partisan support, as various forms of this legislation were part of the Bush Administration's FY 1993 budget proposal, the House tax bill (H.R. 4210) passed last February, the Senate version of that bill, and the Conference tax bill that was vetoed by President Bush last March. Additionally, the bill has received as many as 330 co-sponsors in the House of Representatives in the past. Just recently, restoration of this benefit was recommended by the National Commission for Financing Postsecondary Education in its report "Making College Affordable".

Assistance is needed in this area due to the increasing level of debt. Loans have dramatically increased from 39% of all federal aid 20 years ago to 65% in 1990. This has led to high indebtedness for many students. A recent estimate of average graduating debt for undergraduates at public four programs was over $6500, and was over $9500 at private four year programs. Debt is growing for graduate students due to fewer fellowships and stipends; approximately 50% of all 1991 black and hispanic doctoral recipients in the social sciences had over $10,000 debt. Average graduating debt for medical and dental students is over $50,000, and debts of over $100,000 are not unusual. In medical/dental education debt is significantly higher for minority students. Such debt is a significant burden in the years immediately after graduation; interest alone in these years can be as high as $8000. The growing debt burden for students may discourage entry into higher education and the pursuit of additional degrees, especially for disadvantaged and minority students and those considering professional and graduate degrees.