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Subseries:

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Folder Title:
HOPE [Hope and Opportunity for Postsecondary Education] Act: Tuition Inflation

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Please Turn to Page B10, Column 1

7/22/97

ʼst Gotti, Success Is Best Revenge

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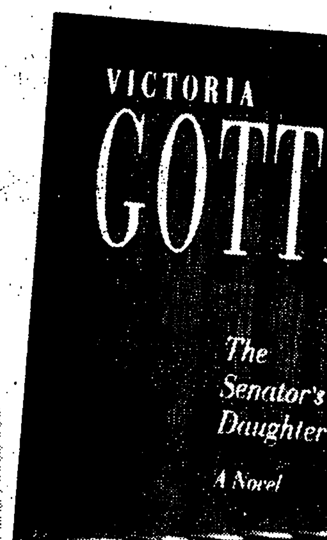
Early rejections for Victoria Gotti's book 'The Senator's Daughter'

"...I'm sorry to say that I just didn't love it enough to see it for our list." — Hyperion

"Overall, I just wasn't thrilled by this thriller enough to take it on." — Random House

"Victoria Gotti is a publicist's dream, but as an editor I didn't warm up to 'The Senator's Daughter.'" — William Morrow

"Obviously, there's a strong media foothold considering the author, but, still, one should feel completely enthusiastic about the book itself and I'm afraid I don't feel that way." — Dell



laced with fear. Recalls her agent, Frank Weimann: "People kept saying, we don't want to do books with those people, or what's going to happen to us if we don't make this book a bestseller?" Some publishers "thought she wasn't going to have a brain in her head," he adds, and, at a time when tell-all memoirs are hot commodities, others "wanted the inside story on her father, or nothing." Ms. Gotti has declined to discuss—or write about—her father's alleged mob ties.

Her novel is a fictional account of the murder of a union strongman and its impact on the life of Taylor Brooke, a beautiful young attorney assigned to defend the black youth accused of the murder. Forge, a tiny imprint of Tom Doherty Associates Inc., finally bought the manuscript late in 1995 for a tidy advance of $70,000 and gave it a respectable 50,000-copy first printing.

So Ms. Gotti has become a minor celebrity in her own right — and nothing these days sells better than celebrity. "The Senator's Daughter" has landed on a number of best-seller lists: No. 10 on Newsday's fiction list and No. 21 on the list compiled by national distributor Ingram

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ʼr Outcast to Toast of TV Land

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with a surprise ruling that cable operators can't push broadcasting stations off their systems regardless of how few viewers the stations bring in. The ruling had the effect of guaranteeing Mr. Paxson a treasured slot on cable boxes reaching two-thirds of the households in America.

Lowell Paxson

"When that ruling came in, I cried," says Mr. Paxson. "Twenty-five minutes later, everybody in my office was drinking champagne, and by 11:30, I had a hangover."

Mr. Paxson has been a minor-league player in TV for decades. A born-again Christian, he is a backer of Christian Network Inc., a small cable channel that scrolls Bible verses down the screen as inspirational music plays. In the 1970s, he helped launch Home Shopping Network Inc., which in its early days peddled can openers on the radio. Before he sold his stake for about $70 million in 1992, one of his partners at the network became the focus of investigations into alleged secret deals with suppliers and hush-money payments. No charges were ever leveled against Mr. Paxson.

His current empire was built by buying up UHF stations on the cheap and running them with a tiny staff that broadcasts infomercials produced by others who pay for them to be aired. Sales in 1996 totaled $144.5 million, up 67% a year earlier.

The wooing of Mr. Paxson illustrates how tough the television business has become. On the one hand, the crunch for channels has meant that established brands have had to fight to get on the tube. At **Westinghouse Electric** Co.'s CBS, for instance, the network's cable upstart, Eye on People, has struggled to get onto cable systems in many of the country's biggest markets despite the CBS brand name and a news-magazine format that has been praised by many critics.

"The name of the game is signing up distribution," says Vinton A.G. Vickers, a broadcasting analyst at Furman Selz in New York. "There are only so many slots."

But as Mr. Paxson has already found, simply getting space on the cable box doesn't mean getting viewers. Many operators have struggled to find enough quality programming to put on their channels. For example, the country's newest broadcast network start-ups, the UPN and WB networks, have faltered in the ratings despite decent distribution.

Mr. Paxson says his preference is to do a programming deal that will meld his

Please Turn to Page B10, Column 4

EDUCATION

Would Tax Plan Further Inflate College Grades?

By WILLIAM M. BULKELEY
Staff Reporter of THE WALL STREET JOURNAL

If President Clinton gets his way, next year's tax season could bring a bit of relief to middle-class families coping with crushing college bills.

But the proposed $1,500 tax credit for parents of college freshmen and sophomores would be contingent on grades: Students would have to have a B-minus average to be eligible. And that provision is stirring surprising concern in higher-education circles.

"I suspect it would be the end of any effort to control grade inflation," says Thomas Bickel, registrar of Dartmouth College in Hanover, N.H.

Though tying financial aid to academic achievement is hardly new, colleges are accustomed to setting their own rules. Most insist that scholarship students remain "in good standing," and that means different things on different campuses. If the Clinton plan is approved by Congress, it could pressure professors to raise grades in certain circumstances, administrators fear. And if so, it would further muddy what has already become a very muddy situation.

Hardly anyone disputes that overall grades have drifted up since the 1960s. In a national survey of college students, Arthur Levine, now president of Teachers College at Columbia University, found that 26% reported better than A-minus averages in 1993, compared with 7% in 1969. Averages of C or below fell to 9% from 25%. Undergraduate grades have become so suspect that graduate schools now give more weight to applicants' standardized-test scores and personal recommendations.

Thus, a growing number of colleges are trying to shore up the integrity of their marking systems. Dartmouth last year revamped its transcripts to inform prospective employers or graduate schools about how a student's grade in a given course compares with the course average.

Last year, Stanford University reinstituted the F for the first time in 25 years. And schools from the University of Minnesota to Mount Holyoke College in South Hadley, Mass., have added pluses and minuses to their letter-grade system, on the theory that more precision will slow the upward creep in marks.

But the Clinton plan's financial incentive, affecting millions of college students, is likely to set a new floor for grades, traditionalists say. If you're worried about grade inflation, "you ain't seen nothing yet," warns Dean Whitla, a special consultant to the dean of Harvard College. Some professors also fear that tying money to good grades will encourage students to take easier "gut" courses, and discourage them from taking math and science, where more students receive C's and D's.

Critics point to the precedent of adult-education programs where employers link tuition reimbursement to employee grades. In such cases, teachers say, marginal students aren't shy about mentioning the financial stakes riding on a low grade. Leslie Hitch, director of the Simmons College graduate program in communications in Boston, says she receives such requests frequently, but won't change grades under pressure.

Department of Education officials argue that the Clinton plan could have a

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Would Tax Credit Bring More Inflation Of Undergrad Grades?

Continued From Page B1

salutary effect on student effort. "Grades may go up," says David Longanecker, assistant secretary for postsecondary education, "because students will work harder and learn more," to keep the credit.

The president's plan is modeled after the popular HOPE scholarships in Georgia, where since 1993, some 80,000 students have received scholarships at state schools if they keep a B average. While there's no evidence that HOPE has led to grade inflation, it seems to have encouraged some students to take easier courses, says the Department of Education's Mr. Longanecker. Georgia school officials, he says, "believe they're seeing some selectivity in curriculum" by students trying to boost their averages.

The president's tax-credit proposal would affect families earning less than $100,000 a year and 4.2 million students, or 29% of the college population, according to the Department of Education. The grade requirement would apply to only half that number because incoming freshmen would get the tax credit automatically.

If Congress approves the tax credit this year, it could show up next spring on tax returns of parents who pay tuition for the 1997-98 academic year. "We're pretty optimistic," about passage, says the DOE's Mr. Longanecker. "The stars seem to be aligning themselves, and education is hot right now." Some Republicans, however, have raised concerns that the Clinton proposal would increase the federal deficit and encourage colleges to boost tuitions.

If it materializes, the tax credit's effect on campus grading policy could be difficult to sort out. One explanation for grade inflation is that the most selective colleges, at least, are getting better students, as measured by average SAT scores and class rank. Given the hoops applicants must jump through to gain admission today, some argue that their generally high grades aren't surprising. At Harvard, the average today is in the B-plus range, up from B-minus 25 years ago. Still, registrars at even top schools say grades have accelerated faster than student talent levels.

Teachers at less prestigious schools appear to be more willing to hand out bad grades, partly because they encounter more students unprepared—or unwilling—to work at the college level. James Ware, vice president of Bunker Hill Community College in Boston, says "grade inflation isn't an issue here." He says the teachers will flunk, even though it means students lose eligibility for federal Pell Grant aid if they aren't making progress toward a degree.

Yet pressure on professors to go easy comes from unexpected quarters. With most schools reducing required courses, teachers are competing to keep classrooms full. "You can be a lot more demanding and a lot less generous in grading in a course that's required of a major" than in an elective, says John Cooper, a Bucknell University chemistry professor and critic of grade inflation. "There isn't an honest faculty member who will say he isn't influenced," in grading policy by the desire to attract students.

Moreover, most schools ask students for evaluations of their teachers after each course. Professors seeking tenure face the greatest pressure. "I've heard anecdotal stories about students warning professors 'we know you're up for tenure. If you don't give good grades, you could get trashed in the evaluations,' " says Dr. Cooper.

At Bucknell, in Lewisburg, Pa., 80% of all grades given are A's and B's, compared to about 50% in the 1960s.

AUTOIMMUNE INC.

AutoImmune Inc. shares plunged after the biopharmaceutical company announced disappointing clinical results of its multiple sclerosis drug. The Lexington,

The Dallas Morning News April 8, 1997 A 15

COLLEGE TUITION

There are explanations, but no excuses, for spiraling costs

JOAN BECK

The only student demonstration I ever led was against my college raising tuition by an outrageous 33 percent. We lost, of course. But the big-time media coverage was gratifying. And for a time, we even dared to hope we had made our point.

Tuition jumps have long since ceased to be news. They now seem as inevitable as taxes, have increased at least twice as fast as the cost of living for years and are related more to how much colleges can extort from families than to a straightforward accounting of costs.

Parents are warned they should start saving for their children's college expenses no later than at birth. If they come up short — and it can cost about $30,000 for one year at a selective private college — they must prove it on intrusive financial aid forms that dissect their income and assets. Then they may get a financial aid package, perhaps with some grant money, but heavy on an array of loans and part-time student jobs.

Colleges have become adept at tapping families for every dollar they can, even stretching college costs over decades — from the years parents are supposed to save before their child's freshman year to the decade or so after graduation it takes to pay off student and other loans.

Now, President Clinton, trying to make political points with parents obsessed and overburdened with college costs, is proposing some relief. His plan is a mix of tax breaks and grants that would cost taxpayers billions of dollars and, in some ways, would make the problem worse.

What is supposed to appeal most to parents is what Mr. Clinton calls Hope Scholarships, which would give parents either a tax credit of $1,500 a year for a child's first two years in college, provided the student maintains a B average and stays off drugs, or a $10,000 deduction from taxable income. The tax breaks would phase out when family income is between $50,000 and $100,000.

The problems with the plan are obvious and were pointed out to Mr. Clinton before he announced it. The tax credits aren't refundable, so the poorer the family and the less income tax it pays, the less help they would be. The new money would reduce the amount of aid that students from poor families get from Pell grants and other federal sources, although the president did propose increasing Pell amounts.

But how would the government make sure a student isn't using drugs? Would he have to submit urine test results with his parents' income tax returns? Or would colleges be required to make spot drug checks of their Hope Scholarship students? Would the requirement that students keep a B average lead to even more grade inflation and to Internal Revenue Service monitoring of college records?

The biggest catch is that the extra money from taxpayers almost certainly wouldn't end up reducing families' exorbitant costs. Instead, it would encourage colleges to raise their tuition even higher, knowing there were extra dollars they could soak up.

Mr. Clinton's plan does nothing to get at a basic question: Why should the total costs of a year of schooling (nine months or less in reality) at a selective private college be almost as high as the median annual household income in the United States?

There are plenty of reasons for the increases in college costs. Enrollments grew rapidly in the 1960s and 1970s, prompting campus expansions, new buildings, more faculty members and administrators. Federal funding has slowed. [illegible]

More...

costs have risen. Security needs have increased. Faculty salaries are higher and teaching loads lighter. Student recruitment expenses have grown. Curriculum choices have expanded. Technology costs are soaring. Affirmative action has increased the number of students needing financial help.

Those who do pay full price may not realize that some of their tuition money goes to provide financial aid for other students from less affluent or less thrifty families. Every time tuition goes up, so must financial aid, until some schools are giving monetary help to almost half of their undergraduates.

Because they haven't encountered any significant consumer resistance, colleges also continue to raise tuition to what they think the market will bear, using creative justifications to show how urgently all that money is needed. And they are getting away with it, as increasing numbers of applications for admission show.

Maybe, after all these years and all those tuition increases, protesting doesn't seem like such a naive idea.

Joan Beck writes for the Chicago Tribune.

SEATTLE TIMES Apr 9 '97

ROSS ANDERSON / *Times editorial columnist*

B-4

There's a conspiracy afoot, and they're after your kids

OLYMPIA — Pick your conspiracy. Left-wing or right-wing. Either way, the kids lose.

Take the conservatives. They've been picking their way through the state schools budget, looking for communist plots. Sure enough, they've identified an evil federal conspiracy to brainwash innocent schoolchildren.

It's called Goals 2000. Here's the deal. The feds offer grants to school districts to do long-term planning to improve student learning. This year, 178 school districts around the state have applied for grants, and the federal government is expected to provide $16 million in assistance.

That's .002 of school spending, but it's money dedicated to planning.

And everybody knows that planning is socialism. State Sen. Harold Hochstatter from Moses Lake rails on the Senate floor, wagging his finger like an Old Testament prophet and warning that "we're getting things very wrong when we take this federal money."

To which Tacoma Sen. Rosa Franklin responds: "But this is *our money*. Our tax dollars. It's for our children."

Spokane Sen. Jim West chimes in: "If it's our money, we shouldn't send it there in the first place. . . . We are a sovereign state. This is like a heroin pusher coming onto the school grounds."

And then the Republican majority votes to just say "no" to $16 million in federal education aid — including money requested by school districts in Hochstatter's and West's home districts.

The giveaway was the name. If the feds had called it Goals 1776, that would have been fine. But Goals 2000 sounds suspiciously forward-looking.

And then, while they're at it, senators vote to eliminate lesser amounts of money for "complex needs" and "magnet schools," both of which target low-income or minority kids — another sign of a plot.

Not to be outdone, liberal Democrats have a conspiracy theory of their own — charter schools.

Charter schools are semi-independent schools set up by groups of teachers and parents looking for new and better ways to educate kids. They use public dollars and are required to follow basic rules — no discrimination, no religious or political propaganda, and so forth.

Democrats, however, are suspicious of anybody who thinks they might have a better idea. So the governor, the superintendent of public instruction and the teachers' union are working quietly to fend off what they see as a right-wing conspiracy.

As evidence, they cite a paper presented to the Christian Coalition last year, suggesting that charter schools is the way to move toward a "universal system of vouchers."

Aha! We told you so . . .

Alas, their theory doesn't stand scrutiny. Hundreds of charter schools are already operating in progressive states such as Massachusetts, Minnesota and California. They don't push religion, nor politics. Most are in inner cities or on Indian reservations, where conventional schools have failed. Most are started by parents and teachers looking for new energy and better ideas.

But the conspiracy theories persist. A charter-schools bill passed the state House last week, but only after being watered down by the governor and other Democrats. The strategy is clear: Pass a charter-schools bill that will not allow any charter schools.

I suppose conspiracies exist. Sinister people sit in smoke-filled rooms, amassing stacks of propaganda or hand grenades, plotting how to infiltrate American institutions.

But this is mostly the stuff of pulp fiction and ideological pamphlets — the same people who believe that Pat Robertson is ripping off little old ladies, or that the United Nations is taking control of our national parks.

This country invented public education and made it part of our national fabric. Today's schools have serious problems, none more serious than the fact that we insist on taking our deepest differences into the classrooms — from school prayer to AIDS, from gun control to censorship.

Let's give schools a break. Goals 2000 was originally conceived in the Bush administration. The idea is to help school districts that would like to do some long-term planning, but can never quite scrape up the money. The feds are offering a little money, no strings attached. Nobody has to apply, and nobody has to take the money.

Charter schools are one way parents or teachers can try something new in public schools. They use the same money as conventional schools, and they succeed or fail based on whether they can persuade enough parents that they can do a better job of educating their kids.

How dangerous is that?

It all depends. One citizen's good idea is another's conspiracy.

Ross Anderson's column appears Wednesday on editorial pages of The Times.

CHICAGO TRIBUNE APR 10 1997

'Brain nourishment' essential for a nation of mentally healthy children

1/9-1 Joan Beck

It's only a one-day conference on April 17, limited to the number of influential people who can be packed into the White House's East Room. But the idea President and Mrs. Clinton are plugging is one of the most exciting of the century, its implications are staggering and its promise is mind-boggling.

The title is almost as long as a press release: The White House Conference on Early Childhood Development and Learning: What New Research on the Brain Tells Us About Our Youngest Children.

It's time the idea got a strong presidential push, especially from a chief executive who wants to be called "The Education President" and a first lady who has found a niche as an advocate for kids.

Research accumulating for more than three decades now shows beyond doubt that the quality and quantity of early mental stimulation—opportunities for appropriate learning from birth on—help determine how capable a child's brain will be for life.

Learning stimulation in the first few years of life actually influences the physical make-up of the brain, how the neurons will interconnect, how well the brain will "think," how "smart" the child will be. Educational opportunities later on in life do not affect the brain in the same way or have such an important impact.

An environment rich in appropriate opportunities to learn can raise a child's potential IQ by 20 to 30 points (by the inexact measures of intelligence available) because of its impact on the development of the brain. Mental malnourishment in the first years of life can lower potential IQ permanently, beyond what even the best schooling can compensate for completely later on.

Schooling can help a child use the brain he has effectively, give him vast amounts of information and motivate him to learn. But only in the early years of life can mental stimulation actually change the brain to make it a more effective organ of thinking.

Now, the challenge is to identify the kinds of learning experiences that nourish young children's brains best and how they can be made available to all our kids. Some participants in the White House conference will talk about model programs being developed in several communities around the country.

Despite the excitement and promise of neurological research on brain development, early learning ideas have been slow to become part of mainstream child care and education.

Many leaders in the growing field of early childhood education are still too tradition-bound to appreciate the potential of the new neurological research and misunderstand early learning as imposing formal and inappropriate lessons on restless youngsters. Their programs concentrate on emotional development, social behavior and nutrition—necessary, of course. But parents, politicians and donors may be misled into assuming they provide more neurologically based mental stimulation than they actually do.

More than half of all mothers with young children now hold jobs outside the home, limiting the time and energy they can devote to their youngsters. Using early learning strategies can make their time together happier, more beneficial to the children and more rewarding for the parents.

Much of what good parents do by instinct or because it makes their children happy provides good nourishment for their brains. Talking to a baby, responding to his efforts to communicate by body language or by babbling, creating safe spaces at home where he can explore freely, just giving him something new to see or do when he fusses out of boredom all help the brain to grow.

Parents need more ideas about brain-nourishing activities. They need more time and more flexibility in their jobs so their children don't have to come in second so often. Most of all, they need a new understanding and appreciation of how much they can contribute not only to their youngsters' physical and emotional well-being but to their growing intelligence.

Public school systems generally ignore children younger than age five and are too hard-pressed financially to explore the possibilities of reach-out programs. Day-care centers often talk about their learning programs but most provide traditional nursery school fare and lack enough trained teachers to give all of their charges optimal, individual mental nourishment.

Many of the special programs set up to give early learning help to high-risk youngsters in poor areas have had only minimal success. They usually use traditional day-care models and give priority to youngsters' urgent physical and emotional needs.

This is what happens in many Head Start programs, which generally offer too little, too late, in the way of mental nourishment. Early Head Start, begun in 1994, is intended to help children from birth to age 3 in low-income areas, but is still too small and too new for good evaluation.

The promises of early learning based on new neurological research are too exciting to brush over lightly or to push aside after the White House conference in the rush of other political matters. It isn't clear yet, however, how best to make the advantages of these new findings available to all our children, especially those in dysfunctional families and those at risk of eventual school failure.

That's where the president and first lady could really make a difference: By sticking with this idea for the rest of his term. By using whatever funding Clinton can bully out of Congress to start and expand model programs. By pestering Head Start administrators to upgrade standard day-care fare with special brain-nourishing components. By generating the national sustained excitement that the promise of the new research deserves.

The idea could do a lot for the Clintons—as well as for the nation's kids.

S. A. Noe

02/26/97 10:45:45 AM

Record Type: Record

To: Robert M. Shireman/OMB/EOP
cc:
bcc:
Subject: Re: Education Q&A

I am concerned about people talking about the Administration's Pell outyear policy when there is no explicit policy. I don't know how Treasury got the $10 billion figure. But in our Budget book, Pell outyear BA is inflated by 2.6 percent per year from the 1998 Reuqest level (that means, FY2002 BA is $8.461billion).

I have an additional comment for the last bullet for the first question. The bullet reads that: "A married couple with $30,000 of income and one child entering college will typically have a 1998 tax liability around $2,220, A HOPE scholarship could reduce this liability by $1,500."

I find this bullet somewhat misleading. This familiy might choose to apply for HOPE, but not for Pell, so that their tax liability could go down by $1,500. But this student would be eligible for a Pell grant that is close to or more than $1,500, so that s/he would get very little or no HOPE. It seems to me that it is more sensible to talk about tax deduction (and Pell) benefits for this particular family.

Robert M. Shireman

Robert M. Shireman

02/26/97 09:21:48 AM

Record Type: Record

To: S. A. Noe/OMB/EOP
cc:
Subject: Education Q&A

--------------------- Forwarded by Robert M. Shireman/OMB/EOP on 02/26/97 09:26 AM ---------------------------

KARL.SCHOLZ @ MS01.DO.treas.sprint.com
02/25/97 02:56:00 PM

Record Type: Record

BY FOCUSSING YOUR EDUCATION PROPOSALS ON THE MIDDLE-CLASS DON'T YOU IGNORE THOSE MOST IN NEED?

No, definitely not. Here is why:

- o The President's budget includes a $1.7 billion dollar expansion in the Pell Grant program in FY 1998 and roughly a $10 billion increase between now and FY 2002. This is the largest increase in Pell Grants in two decades.
  - Eligibility for Pell Grants depends on the need analysis provisions of the Higher Education Act, so nearly 90 percent of the proposed increase will go to families and independent students with incomes below $30,000. The changes will be particularly important for making college affordable to independent students -- those who have to finance college on their own -- by increasing the income protection allowance factor used in the need analysis.

- o The tax provisions of the President's package are designed to help low and moderate income families.
  - The tuition deduction can be used by the majority of eligible families (the jargon is that it is an "above the line" deduction, i.e., taxpayers need not itemize to benefit).
  - The tuition deduction is calculated before the earned income tax credit. Hence, it lowers tax liability without affecting the EITC.
  - Students who pay more in tuition than the maximum Pell Grant for which they would be eligible will benefit from both the tuition deduction and the increase in Pell Grants.
  - Low and moderate income families with a child entering college who do not receive a Pell Grant could have their tax liability sharply reduced by the HOPE scholarship.
  - An independent student with $20,000 of income (too high to be eligible for a Pell Grant) will typically have a 1998 tax liability of around $1,950. A HOPE scholarship could reduce that tax liability by $1,500.
  - A married couple with $30,000 of income and one child entering college will typically have a 1998 tax liability around $2,220. A HOPE scholarship could reduce this liability by $1500.

Office of Tax Policy

February 24, 1997

WON'T THE EDUCATION PACKAGE JUST INCREASE TUITION?

No. Here's why:

- o There are important, structural factors driving up the cost of education that have nothing to do with the effect of policies. Institutions around the country are doing everything they can to control tuition costs. In the highly competitive environment of American higher education, we think there will be little independent effect of the President's proposals on tuition. But let me explain this more precisely:

  - The HOPE tuition credit is only granted to entering students and to second-year students with a B- average or better. Only if the credit were available to all students could colleges increase tuition and not have families' out-of-pocket expenses go up. Fewer than half of all students would be eligible for HOPE scholarships. As a result most institutions will have to be concerned about the effect of any tuition increase on other students.

  - The tuition deduction is available to all eligible families, but every dollar of tuition deduction is only worth the marginal tax rate faced by the family, so families would end up paying most of any tuition increase out-of-pocket.

    -- Given that tuition increases would be paid out-of-pocket for most families, there will be strong competitive pressure on colleges and universities not to raise tuition.

<u>Background</u>

- o We cannot say that the proposal will have <u>no effect</u> on tuition. Two-year institutions that currently charge less than $1,500 per year certainly will be tempted. The best argument we can make in this case is that even these institutions have many students, e.g., those enrolled less than half-time in a degree program, who will not be eligible for the credit.

    -- High-tuition institutions may respond by altering their institutional aid formulas to try to sop up tax benefits without formally increasing tuition.

- o When thinking about this question, it's useful to have a sense of why college tuition has increased faster than the rate of inflation. The phenomenon is at least partly explained by a set of factors that economists call the "Baumol disease" (after the economist William Baumol who first wrote about the idea). The idea is that colleges, like museums and symphonies, are very labor-intensive organizations, with relatively inflexible ways of producing their services (that is, it is hard to substitute machines or lower-price labor for professors in a university). As economy-wide productivity increases, professor's salaries increase. In other sectors, as the price of labor increases, firms substitute into capital and other factors of production, mitigating the effect of increased labor costs on output prices. But since universities, symphonies, museums and the like are less able to substitute other factors of production for labor, their prices tend to increase more rapidly than other sectors of the economy.

Office of Tax Policy
February 24, 1997

JEC Report on HOPE Tax Credit

Q. The Joint Economic Committee released a report last week critical of the HOPE Scholarship tax credit. It concludes that: any economic benefits from increased enrollment would be offset by administrative costs; colleges may increase tuition; and, financial aid could be better targeted.

A. The report actually said that while some analysts think there may be a connection between financial aid and tuition increases, **"[t]here is no conclusive evidence that increased government subsidies mean increased tuition rates."** The Administration agrees with this conclusion.

With respect to the need to target assistance on low income students, the Budget provides for the largest increase in Pell Grants in 20 years. These grants serve the neediest students, while the tax credit provides much-needed relief to middle-income families who are struggling to send their children to college.

On the issue of the administrative burden, the Secretaries of Education and Treasury are working closely with the higher education community to keep any administrative burdens to the minimum necessary to assure the integrity of the tax system.

Hope Scholarships: Unfavorable Assessment from the Joint Economic Committee

Question: Last week (February 18), the Joint Economic Committee of the U.S. Congress issued a report that was highly critical of the President's higher education tax proposals. JEC called Hope Scholarships "a program with significant regulatory burden that does not address investment and growth as effectively as would providing opportunities for the more efficient private sector to allocate resources." Furthermore, the Committee found that the tax credits and deductions could be difficult to administer, may not increase college enrollment as intended, and may give smaller community colleges and proprietary schools incentives to raise their tuitions. How do you respond?

Answer: Though I would never claim expertise on matters governed by the U.S. Tax Code, it seems to me that we in fact encourage certain behaviors and advance societal goals through the tax system. For example, family formation is supported by exemptions for dependents and tax schedules that generally result in higher tax burdens for individuals than married couples or heads of households. Additionally, we agree with the Senate leadership that families should receive a $500 tax credit for each dependent child. Finally, the tax deduction for mortgage interest payments encourages home ownership. Surely, there are dozens of other examples.

We believe that both our citizens and our Nation are well served by encouraging education and training beyond high school. Nearly 80 percent of high school graduates from high-income families immediately attend college after graduating from high school. Low-income students are about half as likely to continue their educations in college. We are proposing significant increases in the Pell Grant program to encourage these students to attend college by easing the financial burden and, thus, to narrow the gap in college attendance between low- and high-income students.

Middle-income high school graduates are likewise less likely to attend college immediately after high school. Fewer than 60 percent of these students, who also typically do not receive Pell Grants, continue in college immediately following high school. We believe it is important to close the college attendance gap between high- and middle-income high school students as well.

In short, we believe our higher education agenda addresses the clearly identified need to close the gap in college attendance rates.

Hope Scholarships: Powerful Incentive for Colleges to Raise Their Tuition Charges

Question: Over the next five years the President's plan would provide taxpayers with more than $36 billion to help them finance their own and their children's college educations. What assurances can you provide that colleges, universities and trade schools will not simply raise their prices to capture this benefit for themselves?

Answer: Postsecondary education institutions face a number of pressures that should keep tuition inflation to a minimum. For example, community college fees are heavily influenced by the community member who takes just one course at a time. These students would not be eligible for Hope Scholarships, and even with the aid of the tuition deduction, would be sensitive to price increases. We also believe that the competition for students among postsecondary institutions will make these schools reluctant to impose higher costs

The possibility for tuition inflation is inherent in many types of student assistance, whether in the form of a scholarship or grant program, or in the form of a tax credit or deduction. We do not believe such concern is warranted enough to deter us from seeking to expand the benefits Americans have realized from student financial aid, particularly when the increases and decreases in student aid over the past three decades have produced little evidence of a relationship between federal aid and college tuition levels

In Georgia--where the HOPE Scholarship idea began in 1993--tuition at public two-year colleges grew by 13 percent between the 1992-3 and the 1995-6 academic years, compared to the national average of 21 percent. Independent colleges in Georgia report that the availability of HOPE Scholarships has mitigated tuition increases by enabling these institutions to reduce the share of tuition revenue that is earmarked for institutional financial aid.

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College Cost: Why Have College Costs Increased?

Question:

Why are college costs increasing?

Answer:

When people think about the cost of higher education, they generally are thinking about the price charged by institutions in terms of tuition and required fees. Since 1990, tuition and required fees increased by 50 percent at public institutions and by 35 percent at private institutions.

A part of the increase in cost at public institutions is the reduction in the level of State institutional subsidies. Between 1980 and 1994, these subsidizes declined as a percentage of total revenue from 44 percent to 33 percent. Over the same period, tuition and fee revenues increase as a percentage of total revenue from 13 percent to 18.5 percent.

Of course, this trend does not explain the increases in cost at private institutions at all, and only explains part of the increase in the cost of public institutions. Besides keeping up with inflation, both private and pubic institutions have needed to provide raises to faculty and staff, and update and upgrade facilities and equipment. In addition, private institutions and, to a lesser extent, public institutions, have needed to increase spending on financial aid by charging those who can afford to pay so that they can award aid to those who cannot.

College Cost: Increases Compared to Family Income

Question:

How much have college costs increased? How does that compare to family income?

Answer:

A family's ability to afford college for its children depends on many factors, including tuition levels, availability of financial aid, family income and assets, and family size. Tuition, room, and board are a measure of the gross price of college. The average cost for tuition, room, and board as a percentage of family income is an indicator of the affordability of a college education.

- Between 1980 and 1994, college costs (tuition, room, and board) rose rapidly in both public and private institutions, but increased more at private colleges than at public colleges (71 versus 45 percent in 1995 constant dollars).

- Between 1980 and 1994, tuition, room, and board at public institutions increased from 10 to 14 percent of median family income (for families with children 6 to 17 years old). This increase was larger for low income families than for high income families -- it increased from 16 to 26 percent for families at the 25th percentile of family income, compared to an increase from 7 to 9 percent for those at the 75th percentile.

- After periods of decline in the 1960s and 1970s, tuition, room, and board at public institutions rose to a high of 15 percent of median family income (for all families) in 1993. At private institutions, tuition, room, and board as a percentage of median family income rose every year between 1979 and 1993, increasing from 23 to 41 percent.

College Affordability

Question: Over the last decade, college prices have increased by over 100 percent, while family incomes have only gone up by about 40 percent. What steps is the Department taking to ensure that a college education remains affordable for American families?

Answer: The President and I are concerned about the impact of rising college costs, and we are committed to making college more affordable for all qualified students and their families.

The President's 1998 budget includes some $4 billion in new tax benefits to help families meet college costs, including:

- The America's Hope Scholarship -- a tax credit of up to $1,500 to first year students and for second-year students who have attained a "B" average, and
- The Middle-Class Bill of Rights tax deduction -- up to $5,000 (increasing to $10,000 in 1999), for an unlimited number of school years.

The Department's 1998 budget would make more than $47 billion in student aid available to some 8 million students --the largest amount in history, and an increase of 10 percent over 1997. Our 1998 budget would --

- Raise the Pell Grant maximum award by $300 (from $2,700 to $3,000) to help over 4 million students from the lowest-income families.
- Increase the Work-Study program to help a almost a million needy students "earn while they learn", while funding the SEOG and Perkins Loan programs to support 991,000 and 810,000 students respectively.
- Support both the FFEL and Direct Loan programs, which together will provide some will provide some $29 billion in new loans in 1998.
- Create a new, merit-based Presidential Honors Scholarship to reward the top 5 percent of the graduating class of every high school in the Nation--an estimated 132,000 students--with $1,000 for the first year of college.

CongressDaily

House Appropriations Chairman Livingston will work with the administration to identify cuts necessary to pay for the Bosnia mission, the aide said, adding that finding defense cuts to boost domestic spending is "problematic." The aide added, "They have not presented us with any rationale for doing this." The aide said the administration wants to bring domestic spending up to levels it had requested, contending that "obviously, they made some promises" to do that. The administration's FY98 budget includes the supplemental requests — ranging from funds for the Women, Infants and Children program to payments owed to the United Nations.

Republicans are particularly disturbed the administration wants additional defense cuts to pay for domestic programs. "The cruelest thing we could do to this president is to give him his own defense budget because he knows he can't live with it and he has proven that point over the past two years," the aide said, adding the administration has had to request supplemental spending for defense programs. House appropriators are likely to begin work on the Bosnia supplemental next month. The aide said another problem is the administration is likely to make an additional supplemental spending request for Western flood recovery — for which Congress will have to find offsets. Administration officials were not available for comment today.

EDUCATION

JEC Study Criticizes Clinton Higher Education Tax Credit

The Joint Economic Committee today issued a report blasting President Clinton's proposals to offer tax deductions and credits to help families pay college tuition costs, calling it "a program with a significant regulatory burden that does not address investment and growth as effectively as would providing opportunities for the more efficient private sector to allocate resources." The committee found the tax credits and deductions could be difficult to administer, may not increase college enrollment as intended and may give incentives to smaller community colleges and proprietary schools to raise their tuitions. In a statement accompanying the report, **Joint Economic Chairman Saxton** said, "We cannot permit the tax law to be used as a vehicle for creating another program that does not accomplish its intended purpose."

Clinton's plan calls for a tax credit of $1,500 for the first two years of post-secondary education in addition to a $10,000-a-year tax deduction for tuition. Both the credit and deduction are limited by income groups, and students must maintain at least a B average to receive the second year of the credit. The JEC report mostly criticized the $1,500 credit: "If the credit were claimed by large numbers of current students, institutions of higher education may choose ' increase tuition and thereby offset, at least partially, the tax benefits to students ... Increa would have a disproportionate effect on low-income students because they tend to be sophisticated with respect to the process for obtaining financial aid." The report add "states with community college tuition rates below the level of the subsidy will autor increase rates as a means of extracting an indirect subsidy from the federal governme

The report charged that requiring students to maintain a B average may force seek easier academic programs at "less challenging institutions," select easier "gravitate to teachers who grade less severely." While the design of the tax credit to apply for than most financial aid packages," the fact that it is issued at the e may require students to secure a loan to cover costs at the beginning of the y Another "complexity" in the program, according to the report, will regulations defining which educational programs are for job training an bies," which in turn will "add to the complexity and administrative cost new plants would also be granted preferential treatment regarding "land use, personnel, and mineral exploitation," according to the ...ficial *China Busi-ne...*

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C... ...ate on the Three Gorges dam with the building of ship locks and a diversion canal. A further $939 million will be spent this year to end the first phase of the dam's construction, with the scheduled closing of the Yangtze River in November.

Once completed in 2009, the Three Gorge project is targeted to produce the equivalent of one-tenth of China's annual electrical power output.□

Tax Policy

Ways-Means Plans Subcommittee Hearings On IRS Taxpayer Advocate, Social Security

The House Ways and Means Committee's Subcommittee on Oversight will hold a hearing Feb. 25 on the first annual report of the Internal Revenue Service's taxpayer advocate, the committee said Feb. 18.

In addition, the Subcommittee on Social Security will begin a series of hearings March 6 on the future of the Social Security system, the committee said.

The oversight panel's hearing on the taxpayer advocate is being held "to identify what further legislative actions may be appropriate to reduce the burdens taxpayers experience in transacting business with the IRS," the committee said.

The Taxpayer Bill of Rights 2 statute (PL 104-168), enacted in July, elevated the position of IRS taxpayer ombudsman, renamed it "taxpayer advocate," and required the advocate to report annually to Congress on how customer service at IRS needs to be improved.

In announcing the Social Security hearings, the committee did not say how many would be held, but did say the first hearing would focus on the report of the 1994-1996 Advisory Council on Social Security.

"We owe it to every American to explore fully every possible option to ensure the future of Social Security, for this generation and the next," said Rep. Jim Bunning (R-Ky), the chairman of the subcommittee. "My aim is for all of us to listen and learn so that we can make the right decisions for Social Security's future."□

Tax Credits

JEC Says Value of Clinton Proposal For Tuition Tax Credit Is Limited

Enough problems exist with President Clinton's tuition tax credit proposal that it would likely be only of limited value in boosting the number of students who can afford a college education, according to a report released by the Joint Economic Committee Feb. 18.

"In general, the tax credit might well induce some new students to enroll, but real economic growth seems unlikely, given the potential for high administrative costs, inefficiencies, and offsetting disincentives," according to *The Administration's Proposal for a Tuition Tax Credit: A Joint Economic Committee Report.*

Clinton's fiscal 1998 budget proposal contains a number of tax incentives designed for higher education. The JEC report focused on the president's proposal for a $1,500 tax credit that would be available to students in the first year of college. Students would be eligible for an additional $1,500 credit in their second year of college if they maintained a B average. The credit would be phased out for upper-income taxpayers.

The JEC report said one potential problem is that the existence of the tax credit could prompt colleges and universities to increase tuition.

"There is no conclusive evidence that increased government subsidies mean increased tuition rates, but a number of analysts see a connection between the increase in government subsidies and the increase in tuition and fees in recent years."

That would mean the benefits the tax credit affords to some students would be offset by increased costs for everyone, JEC said.

Credit Seen Easier To Apply For

In examining how useful the credit would be for low-income taxpayers, the JEC report said its one advantage is that it would be easier to apply for than other forms of aid. But a major drawback is that a low-income student who receives the credit would see other subsidies reduced, including Pell Grants.

Better results might be achieved if Congress did a better job of targeting existing subsidies to low-income students, improved delivery programs for current targeted efforts, or shifted resources into primary and secondary school subsidies, the JEC said. "Those issues need to be reviewed before another broad subsidy is created," according to the report.

Another potential problem with the credit is the increased administrative and regulatory burdens associated with it, JEC said.

"New regulatory, reporting and compliance requirements for taxpayers and schools will broaden the powers of the Internal Revenue Service in the field of education," according to the report.

Those burdens stem from the credit's restrictions, such as the requirement to maintain a B average, which will "add to complexity and administrative cost, both for the taxpayer and the government," JEC said.

Those additional administrative costs would translate into a significant revenue loss to the Treasury relative to the amount of benefits students are receiving, according to the report.

"High cost per student suggests a need to look at alternative approaches to encouraging low-income enrollment such as streamlining the application process

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or lowering the cost of getting information about student aid," JEC said.☐

Tax Practice

More Suspensions, Disbarments Expected By IRS Practice Unit With Aid From Appeals

The practitioner community can expect to see more suspensions or disbarments of its members now that the Internal Revenue Service office that oversees practice is receiving help from appeals officers to resolve cases, the agency's top practice regulator said Feb. 18.

Robert Brauer, IRS director of practice, told a meeting of the taxation section of the D.C. Bar's Tax Audits and Litigation Committee that within the past couple of years, appeals officers have started helping his Washington staff of three attorneys resolve practitioner compliance cases.

There will probably be 50 percent to 75 percent more suspensions or disbarments in the future with these added resources, Brauer said. Three appeals officers from the agency's Philadelphia office and one appeals officer from Newark, N.J., now are actively involved in cases, he said.

About 400 cases are referred to Brauer's unit every year, mostly by field agents, revenue officers, and criminal investigators, he said. The referrals are made out of concern that practitioners violated Circular 230, which governs practice before the Service, he said.

The referrals do not usually specify which provisions may have been violated, Brauer said, noting that "our field folks are not terribly sophisticated with regard to provisions of Circular 230." As a result, about 100 of the referrals are discarded on their face, he said.

Tougher Cases

In the other roughly 300 cases a year, the Service works out the case, beginning with a letter to the practitioner, Brauer said. If a response is not satisfactory, a conference is conducted in which a resolution is negotiated about 90 percent of the time, he said. The remaining cases are worked out in proceedings before an administrative law judge, who renders an appealable decision after a hearing, he said.

There now are about 175 suspensions of certified public accountants every year, and 25 to 30 disbarments of attorneys, each of which is published in the Internal Revenue Bulletin with the name of the practitioner, Brauer said. Suspensions can last from one or two months to several years. Most of the suspensions result from failure to file, he said.

The remainder of the cases typically result in no action or unpublished reprimands, he said.

IRS plans to publish new disciplinary scenarios in the Bulletin in April, spelling out situations that would violate Circular 230, Brauer said.

Separately, IRS this year also plans to update Circular 230 after consulting with the American Institute of Certified Public Accountants and other practitioner groups, he said. The American Bar Association has called for updating at least one area, dealing with solicitations, he noted.☐

— *By Martha M. Canan*

Supreme Court

Justices Reject Equitable Tolling Of Limitations Period For Refund Claims

The U.S. Supreme Court unanimously ruled Feb. 18 that the statute of limitations set out in the Internal Revenue Code for filing refund claims may not be extended on equitable grounds because a taxpayer missed a filing deadline due to physical or mental illness (*U.S. v. Brockamp*, US SupCt, No. 95-1225, 2/18/97).

Writing for the court, Justice Stephen Breyer said that the doctrine of equitable tolling does not apply to the time (and related amount) limitations detailed in Section 6511 of the code for filing tax refund claims.

The court's decision ended a conflict of opinion that had arisen when the U.S. Court of Appeals for the Ninth Circuit decided in favor of equitable tolling in the two cases that the court consolidated for review. Arrayed against the Ninth Circuit on the issue were the First, Fourth, Tenth, Eleventh, and Federal Circuits.

The Clinton administration has proposed as part of its fiscal 1998 budget request to permit equitable tolling of the statute of limitations for refund claims for the period that a taxpayer is found to be unable to manage his or her financial affairs due to a physical or mental disability.

Money Had and Received

The two cases present similar circumstances. In each case, a taxpayer filed a claim for refund of taxes several years after the filing deadline had passed. Each taxpayer, however, invoked equity to toll the limitations period for filing, explaining that he suffered a mental disability (senility in one case and alcoholism in the other) that prevented him from filing his claim on time. In each case, the taxpayer argued that Section 6511 contains an implied "equitable tolling" exception. The Ninth Circuit agreed with the taxpayer's argument in each case.

The taxpayers based their cases for equitable tolling on the court's decision in *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990). In that case, the court considered the timeliness of an employee's lawsuit charging his government employer with discrimination, in violation of Title VII of the Civil Rights Act of 1964. Although the plaintiff's complaint was untimely, the court nevertheless tolled the limitations period. The court declared that the "same rebuttable presumption of equitable tolling applicable to suits against private defendants should also apply to suits against the United States."

The taxpayers pointed out that principles of equitable tolling would have applied had they sued for

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JOINT ECONOMIC COMMITTEE REPORT
JIM SAXTON, CHAIRMAN FEBRUARY 1997

The Administration's Proposal for a Tuition Tax Credit

Executive Summary

The Administration's proposal for a tuition tax credit does not adhere to the principles of good economic design for the tax laws, is of limited value as an incentive for post-secondary enrollment to students at the margin, creates minimal stimulus for economic growth, and has the potential for producing a heavy regulatory burden and high administrative cost.

The Administration's Proposal for a Tuition Tax Credit

The Clinton Administration has proposed a tax credit for tuition payments as a stimulus for investment in human capital and economic growth. This paper presents a review of the efficiency and equity issues in the use of the tax law as a vehicle for promoting social goals. It describes the economic standards for evaluation of tax law proposals and comments on the tuition tax credit proposal in the context of these standards.

The Proposal

On June 4, 1996, the Clinton Administration proposed an income tax credit of $1,500 applicable to the cost of the first two years of post-secondary education. The credit could be applied to education or training at four-year colleges, community colleges, or proprietary training schools. This amount is set at the current average cost of tuition at a community college. It would supplement a previous Administration proposal for a $10,000 a year tuition tax deduction.

The "Hope Scholarship," as the credit is called, supports the Administration's announced goal of establishing a universal standard of at least 14 years of schooling. The $1,500 credit for each student could be claimed for a taxpayer's education or that of a spouse or dependents. Each student would be required to maintain a B-grade average and avoid felony drug offenses. The benefit would be phased out for joint filers with adjusted gross incomes between $80,000 and $100,000 and for single taxpayers between $50,000 and $70,000 and would be reduced by the amount of any other non-taxable Federal education grants received by the student.

To make the proposal deficit-neutral, the Administration raises revenue from a combination of actions: decreasing the amount of multinational corporations' export sales income that could be treated as being derived from foreign sources; auctioning 25 megahertz of the radio spectrum previously reserved for the digital audio radio service; and imposing an international aviation passenger departure fee. An additional budget offset is generated by a reduction in the revenue loss from the proposed $10,000 educational deduction, reflecting eligible taxpayers' selection of the credit rather than the deduction.

The Administration presents the tuition tax credit as a policy for middle-class tax relief which will encourage economic growth and provide additional advantages to lower-income students. These students would not normally involve themselves in the more complicated process of applying for loans and grants or would not be willing to burden themselves with debt. To solve this problem, the tax credit is designed to be available to all eligible students: it does not involve the uncertainty associated with applying for and awaiting approval of loans and grants. As a credit, it provides a relatively greater subsidy for lower-income students per dollar of lost revenue than the Administration's proposed deduction, because the poor face lower marginal tax rates. With the deduction, for example, a filer facing a 28 percent marginal tax rate and deducting the maximum $10,000 would value the proposed deduction at $2,800, while a filer in the 15 percent bracket would receive a benefit of only $1,500 for the same deduction. In the case of the credit, all filers who have at least a $1,500 tax liability would value the credit at that amount.

The Hope Scholarship as an Economic Proposal

The Administration's proposed tax package of the credit and the deduction is unique in that it marks a shift in Federal education policy by making the tax code a major subsidy mechanism. The credit proposal in particular is noteworthy because of its implications for Federal regulation of educational aid and the creation of new requirements for reporting and compliance for millions of taxpayers. These areas until now have been outside the jurisdiction of the Internal Revenue Service.

The broad impact of the tax law makes it necessary for policy makers to consider efficiency, equity, and cost in the design of tax policy. Good design will permit the most efficient allocation of society's limited resources, establish fairness in the structure of compulsive payments to the government, and minimize the resources required to collect revenues and enforce the law. Such standards optimize both the economy's rate of growth and individual living standards and permit the greatest freedom of choice. Most of the regulatory issues surrounding the tuition tax credit have yet to be addressed in detail, but the proposal as it stands can be evaluated conceptually against these standards.

Market Failures, Government Failures and Educational Subsidies

Free markets sometimes fail to incorporate all social costs and benefits. Typically, the market system produces the highest standards of living for individuals in society by moving toward a result in which each additional resource unit creates the same increase in social benefit in each use. In other words, the market tends to equate marginal social benefits to the marginal social costs of moving these resources from other uses. If, however, the market decisions of individuals do not consider the additional benefits to society which might apply, including faster economic growth and greater political stability, governments may intervene to remedy the shortfall. Investment in education is one activity where the social gains usually exceed the benefits to the individual decision maker and is one in which a case for some government action could be made. The need for government action can also be argued in order to correct a bias against human capital investment, because our property rights system does not permit contracts allowing a person to sell a claim against his future work effort. There is no way to capture the repayment stream if the investor is other than the person in whom the investment is made. Thus, compared to investment in physical capital, investment in human capital possibly may be less than optimal and in need of supplement.

Though the free-market system does not function perfectly, the possibility of market failure must be weighed against that of government failure. Among the sources of government failure are the inefficiencies of the bureaucracy and the tendency of the political system to respond to special-interest pressures. Complex government programs like the Hope Scholarship are particularly subject to inefficiencies and mismanagement. The Federal Family Education Loan Program, for example, with its complicated rules applying to millions of students and thousands of schools suffers from managerial weaknesses that in 1991 generated $3.6 billion in taxpayer payments on defaulted loans.[1] Also, in a democratic political system, unconstrained legislatures are often more responsive to the pressures brought to bear by those receiving concentrated benefits from government action than to the interests of taxpayers among whom the costs of such actions are widely dispersed.

Efficiency Considerations

Economists generally accept the market-price mechanism as the most efficient system for controlling the economy and believe that it maximizes the welfare of market participants, if left undistorted. The first generally accepted goal, therefore, in administering a tax system is to minimize market-price distortions. This concept is known as efficiency. It means that the revenue collection system should function without changing relative prices among goods, services, and factors of production, so that there is no effect on the decisions of individuals about how they consume, work, or invest. An efficient tax code would not contain scores of exemptions, credits, deductions, and other exceptions to the basic provisions of the code needed for raising revenues, unless there is a clearly identified need.

Tax policy should permit the market system to ensure maximum flexibility for consumers and the owners of the factors of production. One test of the efficiency of a proposal is the degree to which participants maintain their freedom to choose among options. The tuition tax credit, however, is very limited in the way it may be used. For example, the Administration wants it to be available only for the first two years of post-secondary education, which limits students and their families in the efficient use of financial aid. Likewise, the B-average requirement, which may force students to seek easier academic programs, is more limiting than the C-average necessary for graduation.[2] Other limitations apply as well.

There is one potentially important way in which the credit may prove to be inefficient as an incentive for investment. If the credit were claimed by large numbers of current students, institutions of higher education may choose to increase tuition and thereby offset, at least partially, the tax benefits to students. There is no conclusive evidence that increased government subsidies mean increased tuition rates, but a number of analysts see a connection between the increase in government subsidies and the increase in tuition and fees in recent years. For example, the American Council on Education, which represents colleges, notes, "College prices have continued to rise because the market has been able to bear the increases. Most institutions have been able to raise tuition and still have full classrooms."[3]

The benefits to some students could be offset by the higher tuition rates paid by all. Increases would have a disproportionate effect on low-income students because they tend to be less sophisticated with respect to the process for obtaining financial aid as an offset to tuition increases. In addition, low-income students are subject to the same tendency of students in general to look more at explicit tuition prices as the chief factor in their investment decision rather than the net cost calculated with grants, loans, or tax relief included.[4]

Another efficiency issue is whether there is need for another broad subsidy to solve the theoretical problem of the market's failure to invest sufficiently in human capital. In addressing market failures, it is impossible to have a clear measure of the shortfall being addressed, but this should not prevent policy makers from asking whether the current subsidy level is sufficient in light of alternative social requirements. There already exists a considerable higher-education subsidy. Current state-level direct subsidies to post-secondary institutions are about $48 billion a year, and the Federal direct subsidy is $26 billion. In addition, the Federal government sponsors $32 billion in student aid in the form of outright grants, subsidized loans, veterans assistance, and unsubsidized loans--an increase in real terms of 68 percent in the last ten years. In fact, subsidies are so substantial that tuition covers less than half of college costs on average. Better return on government subsidies may be possible by targeting low-income students, shifting resources to primary or secondary school subsidies, or improving the delivery programs for existing targeted subsidy efforts. These issues need to be reviewed before another broad subsidy is created.

Equity in the Tax Law

A second goal in the design of tax law is fairness or equity. Generally, as a revenue-raising matter, the law should treat all members of the same group equally, with income level being the usual determinant for defining groups. "Horizontal" equity refers to the similar treatment of everyone in the same income class. In addition, the current U.S. standard is one which also seeks proportional sacrifice--that sacrifice should be proportional to income, as with progressive income tax schedules--known as "vertical" equity.

Equity in revenue collection typically takes a back seat in discussions of tax policies designed to address social problems. For instance, the tax credit proposal violates the horizontal equity standard for the income group by giving the credit to only a few in the group. The social goal becomes the defining measure of fairness. Thus, the equity in a program with social goals must be measured in the context of the need for the program. One of the problems generated by growing tuition costs is a disparity between the enrollment of high and low-income youth. This indicates that there is a need to address the education of the disadvantaged. Compared to the Administration's tax deduction proposal, the tuition tax credit does favor those with less income by phasing out the credit for wealthier taxpayers. It is designed, in part, to adhere to the principle of vertical equity.

Part of the equity issue facing policy makers in student subsidy design, however, is how well low-income families respond to available subsidies. Family income seems to be the key variable in predicting whether a young person will make the investment. This may be related to difficulties in learning about and applying for educational assistance. Like most students, lower income students appear to respond primarily to the gross tuition price without considering possible subsidies. In addition, low-income families are less aware of the aid opportunities like Pell Grants for which they would easily qualify, and, when faced with aid applications, have problems in understanding the technical language used to instruct them in describing their financial assets.

As a subsidy to lower income families, the tax credit proposal has several deficiencies. One problem is that the credit would be subtracted from Pell Grants and some other public subsidies. The Pell Grants, in particular, are the chief direct grant subsidy for low-income students, and any offsets between these two programs greatly reduces the progressivity of the credit proposal. At least one educational expert sees the proposal as a "grossly unfair tilting of resources away from students who have the greatest need in favor of higher-income families."[5] A second problem arises with the likelihood that low-income families will not overcome cultural and administrative hurdles and take advantage of the subsidy. The design of the subsidy also needs to address the special needs of low-income families having little experience with complex application forms, with a reluctance to be encumbered with debt, and with a preference for certainty as to the availability of funds. In this case, the tax credit is easier to apply for than most financial aid packages, and it is available to all with tax liability who are eligible, thereby increasing the student's ability to rely on the subsidy. The timing of the payment, however, especially a credit coming after the tax year, may require the student to secure a loan.

Administrative Costs

Good tax policy design should also minimize the cost of revenue collection; and, if the code is employed as a means for executing social policy objectives, movement toward the desired goal should also be maximized at the least possible administrative cost. These costs include, on the government side, the money spent on administrative staff to ensure enforcement, and, for the taxpayer, the time and effort expended to understand the law, to calculate obligations, and to hire any expert advisors.

The restrictions on the use of the credit announced thus far--such as the artificially high minimum grade requirement, the applicability of the credit only to the first two years of post-secondary schooling, and the prohibition on the subsidy of hobbies--add to complexity and administrative cost, both for the taxpayer and the government. For example, because the proposal omits hobbies as a subsidized educational pursuit, there will need to be a fairly detailed description of what qualifies as a hobby. Eventually the issue of taxpayer intent in selecting specific courses will complicate regulation writing. An estimate of administrative cost must await the writing of regulations and guidelines, but concerns about further intrusion by the government into academic records is just one example of the types of costs, both financial and social, at issue. Treasury officials have apparently expressed concerns over the possibility of fraud in the Hope Scholarship program, evidence of the need for considerable regulatory effort on their part if the program were enacted.[6] New regulatory, reporting, and compliance requirements for taxpayers and schools will broaden the powers of the Internal Revenue Service in the field of education.

Revenue Loss

Revenue loss to the Treasury is a measure of alternatives foregone to the policy maker--alternative tax reductions or new spending programs--and is a proxy for the real cost of the proposal. The revenue loss per new student for the tuition tax credit will be significant, since studies have provided little evidence of increased enrollment rates from previous subsidy efforts. Treasury Secretary Rubin has objected to the credit proposal on the grounds that the subsidy would only go to students who were already planning to enroll.[7] High cost per student suggests a need to look at alternative approaches to encouraging low-income enrollment such as streamlining the application process or lowering the cost of getting information about student aid.

Economic Growth

Investment in human capital, like investment in physical capital, will increase the productivity of the economy, but the success of the tuition tax credit strategy depends on two key assumptions. The first is that more students will enroll in post-secondary programs as a result of the subsidy. Studies of educational enrollment patterns generally do not provide a clear answer to the question of how subsidies affect enrollment, but most evidence finds little support for the notion that subsidies by themselves encourage significant numbers of students to enroll.[8] From this perspective alone, the economic stimulus may be negligible.

The second assumption is that post-secondary schools will not raise their tuition rates. A tuition increase would not only offset some or all of the effects of this subsidy on potential students but also discourage currently enrolled students. One perverse result might be that states with community college tuition rates below the level of the subsidy will automatically increase rates as a means of extracting an indirect subsidy from the Federal government.[9]

Stimulus to economic growth also depends upon how the proposal is financed within the context of overall national resource use--that is, consideration of the alternatives foregone. In the case of a tax reduction, disincentives are inherent in the fiscal changes planned to "pay" for the tax reduction in a deficit-neutral environment. The Administration is proposing $4 billion in revenue increases annually from existing and proposed programs to pay for this credit, and, as a general rule, these increases themselves usually will have disincentive effects in the markets to which they apply. Among other sources, these disincentives could arise as the result of the international aviation departure fee and the tax increase for multinational corporations.

In the macroeconomic context, spending levels are a reasonable measure of the total burden of government programs on the more efficient private sector of the economy and more relevant to the issue of stimulus than revenue levels. Since spending levels are not reduced by this tax credit proposal, it is difficult to argue that there is any fiscal stimulus from a purely macroeconomic perspective. Raising taxes in another segment of the economy, as this proposal does, or borrowing in capital markets to cover revenue losses, does little to stimulate the economy, since the burden on the private sector workhorse is not reduced.

In general, the tax credit might well induce some new students to enroll, but real economic growth seems unlikely given the potential for high administrative costs, inefficiencies, and offsetting disincentives.

Conclusion

The Administration's Hope Scholarship will be a program with a significant regulatory burden that does not address investment and growth as effectively as would providing opportunities for the more efficient private sector to allocate resources. From the perspective of efficient tax design and productive investment, a reasonable alternative would be the removal of the many special provisions in the law (which as a group tend to neutralize the advantages sought by the special interests who supported them), permitting the increased efficiency and lower costs of a simpler tax code with lower marginal rates provide the economic stimulus.

From the education policy side, there should be a targeted assistance program for low-income students, with programmatic changes designed to overcome the special hurdles associated with understanding existing aid programs. The Congress recently increased Pell Grant funding by $1 billion to $5.9 billion and raised the work-study appropriation by 35 percent to $830 million. As a complement to these initiatives, policy makers should consider ways to overcome the difficulties facing disadvantaged families in learning about and applying for student aid. Counseling programs at public schools or community-based organizations might serve this need.

This Joint Economic Committee report was written by Senior Economist Hayden G. Bryan.

Endnotes

1. United States General Accounting Office, *High Risk Series: Guaranteed Student Loans*, December 1992.

2. Possible scenarios for seeking relief from the B-average rule include enrolling at less challenging institutions, selecting easier courses, or gravitating to teachers who grade less severely.

3. Quoted in Robert J. Samuelson, "The Hypocrisy Scholarship," *The Washington Post*, February 12, 1997.

4. Gary Orfield, "Money, Equity and College Access," *Harvard Educational Review*, Fall, 1992.

5. Lawrence E. Gladieux, Executive Director for Policy Analysis for the College Board, quoted in "GOP Queries White House on Tuition Tax Breaks Plan," *The Washington Post*, January 23, 1997.

6. *Washington Post*, January 29, 1997.

7. *Washington Post*, February 3, 1997.

8. Thomas J. Kane, "Rising Public College Tuition and College Entry: How Well Do Public Access Subsidies Promote Access to College?" Working Paper 5164, National Bureau of Economic Research, July 1995.

9. *Tax Notes*, December 16, 1997.

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COMPETITION IN HIGHER EDUCATION AND THE ABILITY TO RAISE TUITION

- The market for higher education is extremely competitive. There are 1,500 community colleges in the United States, with enrollment of 6 million students. Competition among the community colleges, as well as competition with other providers of higher education, limits their ability to raise tuition. As Robert Atwell, president of the American Council of Education, has stated, colleges "wouldn't want to drive more students away by raising costs." [*New York Times*, December 19, 1994]

- Georgia's experience may illustrate the beneficial effects of competition in limiting any price increases from tuition subsidies. Tuition costs in Georgia, home of the Hope scholarship program upon which the President's proposal is based, have risen relatively slowly since the program was introduced in 1993. Between the 1992-3 academic year and the 1995-6 academic year, tuition at public 2-year colleges in Georgia rose 13 percent -- from $937 to $1,062. In the U.S. as a whole, tuition rose 21 percent -- from $1,026 to $1,245. [Digest of Education Statistics 1996, Table 310.]

- In addition, other types of Federal aid do not seem to have much effect on tuition costs:

  -- According to data from the College Board and the Department of Education, real Federal aid to college students rose 7 percent per year during the 1970's, but real college tuition and required fees at public colleges fell slightly (as did real tuition and required fees at 2-year public community colleges).

  -- The pattern was reversed during the 1980's: real Federal aid fell by 1 percent per year, while tuition rose by 4 percent per year in real terms (and tuition at 2-year community colleges rose by 3 percent per year). So there is no simple connection between tuition and Federal aid to higher education.

  -- As Robert Atwell, President of the American Council on Education, has stated: "When William Bennett was Secretary of Education in the 1980's, he argued that if you raised Federal aid to education, tuition would increase, but the evidence of the 1970's and 80's demolishes that."[*New York Times*, December 19, 1994]

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