Oral Testimony of Dr. Susan Dynarski

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Chairman Grassley, Senator Baucus, Members of the Committee, I am honored to have the opportunity to testify before you today.

A college education is a good investment. Over a lifetime, a worker with a bachelor's degree earns, on average, a million dollars more than a less-educated worker.

But college remains out of reach for many. While a third of young white people earn a BA, only 13 percent of African Americans and 8 percent of Hispanics grab that golden ticket. Even among the smartest kids, income is a strong predictor of college attendance. Three-quarters of upper-income kids who do well on tests in high school go on to college, but less than a third of those who grew up in a low-income family. [1]

Designing Effective Education Tax Incentives

I give you these statistics to get us thinking about our goals for the education tax incentives. Whether they have been a success depends on the goals we set for them.

Is our goal to ease the pinch of college costs for middle- and upper income families whose children attend expensive private schools? If so, then the tax incentives do a passable job. I give them a C.

I believe our goals are more ambitious:

- Increase the skills of our workforce.
- Maintain America's competitive edge in the global economy.
- Make college a reality for smart but poor kids who believe it is out of reach.

If *these* are our goals then the current tax incentives are a failure.

Why? The tax incentives can *increase schooling* only if they put money into the hands of kids for whom price is a barrier to college. We need to cut the price of college for those who would not go to college in the absence of the incentive.

- Who are these potential college students? Disproportionately, they are from low-income families. Just half of low-income youth go to college right after high school, compared to 80 percent of their upper-income classmates.[2] They are disproportionately nonwhite or Hispanic.

- Where might these potential college students go to school? The local community college, where tuition and fees average $2,200, or a state university, where costs average $5,500 (College Board, 2005b).

See Figure 1.

This is who we should keep in mind as we design tax incentives for college: a low-income person attending an inexpensive public college. The student admitted to Yale, or Williams, or Dennison, whose family earns $100,000, is going to college with or without a tax incentive, and we should not build our education policy around the prices she faces.

It is not the job of government to make Harvard affordable to the handful who can attend that elite institution each year. It is the job of government to make a solid college education affordable to the millions for whom a BA or AA from a public college is a ticket into the middle class.

The Education Tax Incentives Don't Reach the Right Students

The education tax incentives do just about nothing for low-income students at inexpensive public colleges. Perversely, the tax incentives are focused on upper-income students at the most expensive private colleges.

- Because the education tax credits are not refundable, a family of four must have income above $30,000 to get the maximum credit. Nearly half of families with college students do not get the full credit because their income is too low (Long, 2004b).

- Only students who pay tuition and fees over $10,000 a year get the full Lifetime Learning Credit. This is nearly double the cost of the typical, public four-year college and four times that of the typical community college. Over 80 percent of college students attend schools with tuition and fees under $10,000.[3]

- The expired tuition deduction was most valuable to those in high tax brackets. Deducting $1,000 from taxable income is more valuable for someone in the 33 percent bracket than for someone in a lower bracket. Over half of the benefits of this deduction accrued to households with incomes over $100,000 (Burman, *et al.*, 2005).

The Education Tax Incentives Are Complex and Confusing

The regressivity of the tax incentives is not all that hampers their effectiveness. They are too complicated and confusing to affect schooling decisions. Families can't respond to a price subsidy if they do not understand it.

Again, let's keep our target student firmly in mind. Those on the margin of college entry are disproportionately low-income, nonwhite and Hispanic, with parents who did not graduate college, or perhaps even from high school. For many of these families, English is the second language.

In this context, the education tax incentives are far too complicated to do their job. The IRS publication devoted to explaining them is 82 pages long! The consequences of this complexity extend beyond mere annoyance and frustration. Evidence shows that simple, easily communicated financial aid programs have a robust impact on college entry and completion, and complicated programs don't.[4]

Simplify and Focus the Education Tax Incentives

The goals of reform should be to *focus* the incentives on those who are on the margin of attending college and s*implify* the incentives so that families can understand and respond to them.

1) Create a single, refundable tax credit for tuition, fees, room, and board.

- Merge the Hope and Lifetime Learning Credits into a *single credit*. A single credit would significantly reduce complexity, enabling families to estimate their likely credit well in advance.

- Make the credit *refundable* so families in lower tax brackets are eligible for the maximum benefits.

- Count tuition, fees, room and board as eligible expenses for the purposes of the credit. This matches the definition used for the 529 and Coverdell accounts. It also extends the full credit to the vast majority of students who attend public colleges.

2) Deliver the credit at the time of college enrollment.

- Families need the credit when tuition is due, not a year or more later when taxes are filed. The Department of Education delivers grants and loans to students and their colleges at the time of enrollment, so this can be done.

- IRS can use previous year's income to define eligibility for the education tax credit, so that eligibility is know early.

A Simplified Credit Families Can Count On

The simpler and more streamlined the tax benefits, the easier they are to communicate to families and students.[5] Just as workers are annually sent projections of their Social Security benefits to help them plan for retirement, families could be sent estimates of their tax benefits to help them plan for college. This early, clear information would give students and families confidence they can afford college, and encourage them to work hard in elementary school and high school.

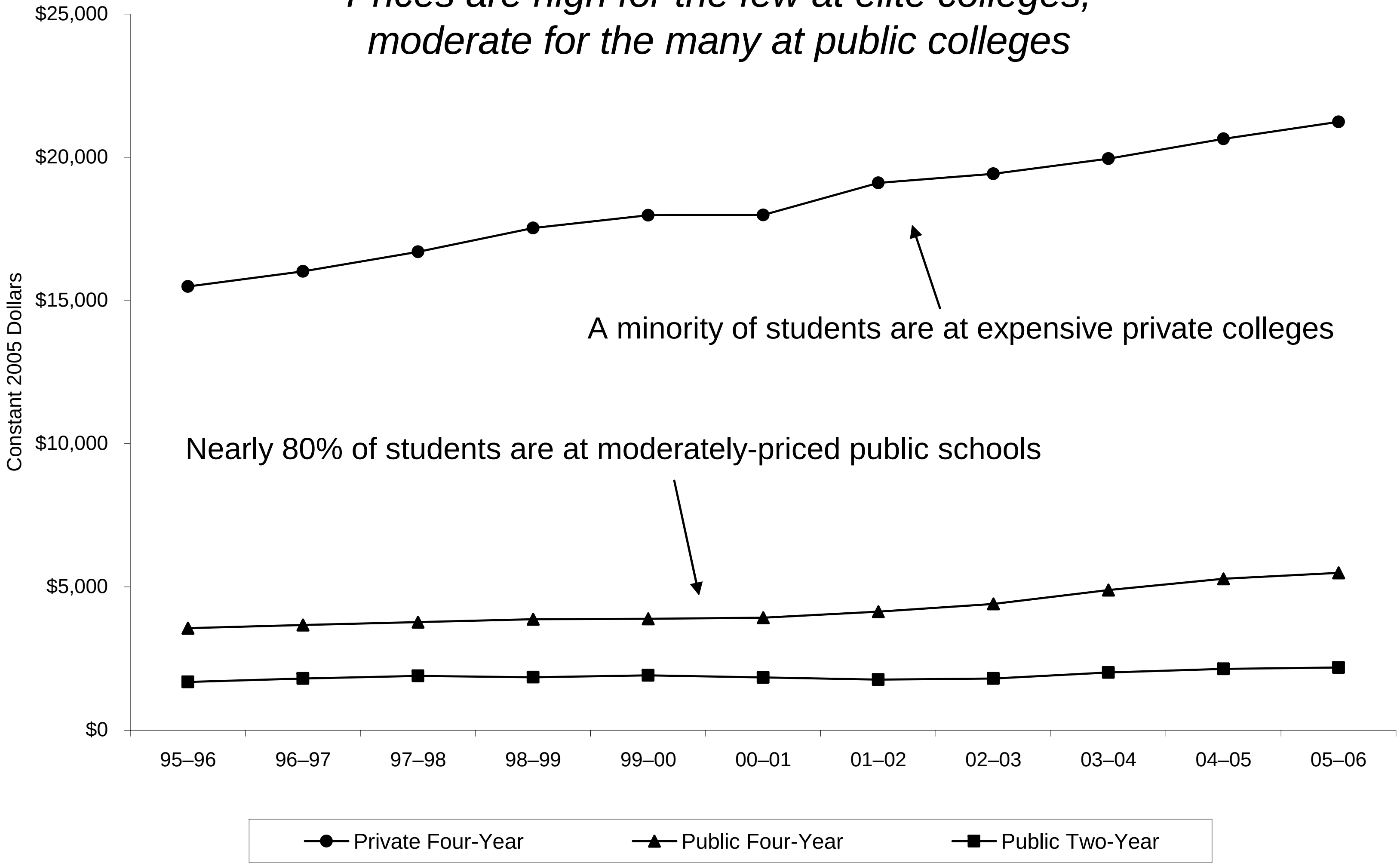
We could even more radically simplify federal benefits for college by consolidating *all* aid for college under the auspices of the IRS. College students and their families now face two parallel, duplicative and unwieldy bureaucracies that provide aid for college: the tax system and the aid system. Moving aid determination into the tax system would substantially simplify the aid process for families.[6]

Conclusion

A well-educated workforce is key to the economic competitiveness of the United States and the well-being of its families. The federal government could do better with its tax incentives for college. Although the education tax benefits provide relief for middle- and high-income families with children in college, they do little to get more people into college. Simplifying and focusing the tax incentives will allow them to serve their goal: opening the doors of college to those who have the ability but not the means to further their education.

Figure 1: Tution & Fees

Prices are high for the few at elite colleges, moderate for the many at public colleges



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Endnotes

[1] BA statistics are tabulations of completed education of 24- and 25-year-olds from 1998, 1999 and 2000 October Current Population Surveys. College attendance statistics by income and test score are from U.S. Department of Education (2005).

[2] College Board, 2005a. Figures are for the top quintile of family income (above $78,000) and bottom two quintiles (below $31,000).

[3] Ninety-five percent of full-time students at public four-year institutions pay less than $9,000, while all two-year public colleges cost less than $10,000. Even if we include private four-year schools, 67 percent of full-time students at four-year institutions pay less than $9,000. See College Board, 2005b.

[4] Dynarski and Scott-Clayton (2006) review the empirical evidence on the types of aid programs that increase education. Long (2004a) shows that the current tax credits do not increase college attendance.

[5] In Georgia, for example, a simple aid program has increase college attendance and completion (Dynarski, 2000, 2004a, 2005). Ninety percent of high school freshmen can name the program and a majority know its eligibility rules, because they are easy to explain and remember.

[6] The federal aid application (the FAFSA) makes the IRS tax forms look svelte. The IRS 1040EZ is a single page with 37 questions. Form 1040A is two pages, with 83 questions. Form 1040 is also two pages, with 118 questions. The FAFSA is *five* pages, with 127 questions. A handful of these questions determine most of the variation in aid. For example, earnings, marital status, family size, and number of family member in college explain 80 percent of the variation in Pell Grants (Dynarski and Scott-Clayton, 2006).