

Written Testimony of James J. Duderstadt  
President Emeritus and University Professor of Science and Engineering  
The University of Michigan

to the

U. S. Senate Finance Committee

December 5, 2006

## Executive Summary

Thank you, Mr. Chairman.

As you know, earlier this fall Secretary of Education Margaret Spellings received a report from her Commission on the Future of Higher Education conveying a number of troubling concerns. Among the findings included in the report produced by that commission, of which I was a member, were the following:

- While in today's global, knowledge-driven economy a college education is more important than ever, too few Americans have that opportunity.
- There is ample evidence that qualified young people from families of modest means and minority groups are far less likely to attend college than their affluent peers. Today students from the highest income quartile are ten times more likely to attend and graduate from college than those from the lowest quartile.
- The manner in which we finance higher education in America is under increasing strain as institutional costs continue to rise, state support for public universities continues to decline, and the tuition and debt burdens on students soar.
- Our financial aid programs at the federal, state, and institutional level are not only confusing and complex, but they fail to address adequately the needs of low and middle-income students. Key here has been the shift of federal programs over the past several decades from an emphasis on need-based grants to subsidized loans to tax benefits even as the states

and institutions have increasingly emphasized merit- based over need-based financial aid.

While many of the answers to these dilemmas lie within the jurisdiction of other committees of Congress, federal tax policy can and does play a role in the support of higher education. Current tax policies both assist parents in saving and paying for the college education of their children. It also provides strong incentives for donors to contribute to a variety of purposes in higher education.

Yet while most of these tax benefits contribute substantially to our colleges and education, some have drifted rather far from the tax-exempt purposes of education and scholarship. I have written in the past about my concerns about intercollegiate athletics and argued that tax policy is fueling an arms race in stadium construction, coaching salaries, and student exploitation in big time sports such as college football and basketball.

To be sure, federal tax policy helps create a balance between public and private support that has been key to the great diversity and quality of American higher education that is very much envied by the rest of the world. What our tax and student aid policy does not do as well as it should, is to assure that help is directed at the students with greatest financial need so that they can attend college.

The challenge is clear: how do we make sure we provide the right tax structure to go along with broader education policy changes that will ensure access and affordability for higher education for the millions of Americans who need the financial help? It is imperative, both as a matter of social justice and economic competitiveness, that our nation address and remove those factors that

have created a strong dependence of access and success in higher education upon socioeconomic status while sustaining America's leadership in higher education.

Mr. Chairman, as you begin to look at tax policy broadly in the next Congress, let me suggest that the Committee look at partnering with the Health, Education, Labor and Pensions Committee and other relevant Senate committees in determining the proper role for tax policy to play in making sure more American students attend and succeed in college.

There are others on this panel with more tax policy experience than I who may be able to suggest creative new ways of using our tax system so that more American students can achieve greater skills and abilities through higher education. However I can state that the higher education community would welcome the opportunity to explore those and other ideas with the Committee in the next Congress. Working together, we can begin to tackle these issues that will enable all Americans to benefit from educational opportunity and, in the long run, will determine the very future of America's economic and national security.

### The Concerns

Earlier this fall, the Secretary of Education's National Commission on the Future of Higher Education in America (the Spellings Commission) delivered a final report conveying several serious concerns:

- In today's knowledge-driven society, higher education has never been more important. Yet too few Americans prepare for, participate in, and complete higher education.

- The Commission is especially troubled by gaps in college access for low-income Americans and ethnic and racial minorities. Notwithstanding our nation's egalitarian principles, there is ample evidence that qualified young people from families of modest means are far less likely to go to college than their affluent peers with similar qualifications. While over 75% of students from the top economic quartile will graduate from four-year institution, only 8% of the lowest quartile will achieve this goal—almost a factor of ten difference in access and success in higher education.
- Our higher-education financing system is increasingly dysfunctional. State subsidies are declining; tuition is rising; and cost per student is increasing faster than inflation or family income.
- The entire financial aid system – including federal, state, institutional, and private programs – is confusing, complex, inefficient, duplicative, and frequently does not direct aid to students who truly need it. Need-based financial aid is not keeping pace with rising tuition.
- Furthermore, affordability is directly affected by a financing system that provides limited incentives for colleges and universities to take aggressive steps to improve institutional efficiency and productivity. Public concern about rising costs may ultimately contribute to the erosion of public confidence in higher education.

Traditionally, the role of the federal government in higher education has consisted of three elements: i) direct funding of academic institutions to support particular national priorities such as research and development and graduates in key strategic areas such as science, engineering, and medicine; ii) financial aid to

students to enable broader access to higher education, and iii) tax policies designed to stimulate private investment in higher education.

As recent studies such as those by the Council on Competitiveness and National Academies have stressed, federal support of research and graduate education is currently neither adequate nor well aligned with the economic and security needs of a nation facing the flattening world of a global, knowledge-driven economy. However the Senate has recently taken important steps to address these concerns through legislation introduced earlier this year by Senators Alexander, Domenici, and Bingaman.

The Spellings Commission believes that today's federal student financial aid system is simply not adequate to meet the needs of low and middle-income students. The transition over the past several decades from a system focused on need-based grants (such as the Pell Grant program) to subsidized loans has saddled students with heavy debt burdens while unnecessarily subsidizing the commercial lending industry. Furthermore, the further shift of the system toward tax benefits primarily benefits more affluent students and their families rather than those with most need.

Federal tax policy has been extremely important in stimulating support from the private sector for higher education, now estimated to provide more than half of the nation's resources for higher education. This balance between public and private support has been key to the great diversity and quality of American higher education and is very much envied and increasingly emulated by other nations. Similarly the beneficial tax treatment of college savings accounts has encouraged the savings efforts of American families and their ability to afford college. However there remain problems with current tax policy,

resulting both from the susceptibility of the tax code to manipulation by special interests and because of the law of unintended consequences.

An example of the former is the perverse treatment of intercollegiate athletics, in which mandatory fees for athletic events such as luxury skybox leases and licenses to purchase season tickets are treated, in part, as charitable contributions by the current tax code. Ironically these revenue streams are now fueling an arms race in college sports, driving universities to debt-finance massive stadium expansion projects, exploit young student-athletes, and tolerate multimillion dollar coaches salaries, all demanded by big-time college football and basketball programs that have been transformed into commercial entertainment businesses with only marginal relevance to the educational (and, I might add, tax-exempt) mission of the university.

Ironically, the broader higher education tax policies concerning private gifts, endowment income, and tuition and other college expenses may also be having some unintended consequences of a very similar nature. For example, the “edifice complex” that stimulates naming gifts from donors for new capital facilities frequently results in campus monuments such as museums, theaters, or sports facilities only marginally related to the academic mission of the university, yet requiring massive additional investment in both construction and long-term maintenance. Some believe that the recent escalation of the salaries of university presidents into the million-dollar range is been driven in part by their fund-raising role. And while the setting of tuition depends on many factors, including state support for public institutions, some institutions may be inclined to increase tuition in response to the increased capacity of students and parents provided by beneficial tax policies.

Others on today's panel are far more capable of addressing the key policy issues associated with the federal tax treatment of higher education. However as an educator, it seems clear that while America's generous tax policy toward higher education has been a very important--indeed, an essential--element in providing our nation with a higher education enterprise that is the envy of the world, there are also clearly some features of these policies that need attention and fine-tuning from groups such as the Senate Finance Committee.

### The Challenge

Education has become a key determinant of one's personal standard of living and quality of life. The breakpoint between those who succeed in college and those who fail is perhaps the most critical decision point in one's life. Yet many recent studies have revealed the degree to which access to higher education in America has become increasingly stratified according to student financial circumstances, thereby undercutting the fundamental principles of equity and social justice. Today even the most academically talented students in the lowest economic quartile are significantly less likely to have access to the benefits of higher education than the least academically qualified students in the top quartile--a situation clearly intolerable for a democratic society.

It is certainly the case that educational costs experienced by institutions and hence the tuition charged to students has been increasing rapidly over the past two decades. Yet here it is important to realize that in most colleges and universities, tuition covers only a fraction of the educational costs borne by the institution, e.g., typically about one-third of the costs of public institutions and one-half of those of private institutions. Furthermore, when financial aid is taken into account, many students pay only a fraction of the stated tuition "sticker price"--in fact, many effectively pay no tuition at all. Access to higher education



today remains high for most of our population, both because of the availability of financial aid programs and the great multiplicity and diversity of colleges and universities, ranging from local community colleges and regional four-year institutions to small liberal arts colleges and proprietary (for-profit) institutions to elite private universities and massive public research universities.

Since the tuition or price charged to students represents only a fraction of the actual educational costs, it is determined both by the amount of institutional support from other sources (e.g., state appropriations) and by the marketplace (particularly for private colleges and universities). For example, for public institutions, which enroll roughly 75% of all students, the states provide appropriations from tax revenues that support the rather substantial price discount from the actual costs. But in hard times, when the states cut back their appropriations, then the discount shrinks, and students either have to pay more or universities have to cut programs. Actually, both usually happen. Such has been the case recently, as state support of public colleges and universities has dropped to the lowest level in 25 years on a per student basis. A New York Times editorial put it well: "The United States has moved entire generations into the middle class and beyond by subsidizing public colleges, putting higher education within the reach of many deserving low-income students. The public college system is in steep decline, however, because of decades of declining support from states that historically kept educational quality high and tuition low." (NYT, 2004).

In the past, financial aid programs at the federal, state, and institutional level have been primarily designed to address the financial needs of students in an effort to enable access and success in higher education. Yet today we suffer from a patchwork federal, state, and institutional financial aid programs, which have evolved over the years more as a consequence of the political process than

any defined purpose or accountability with respect to impact or efficiency in achieving student access or success in higher education. Today a very significant fraction of public funding for post-secondary education goes primarily to benefit affluent students with modest economic needs, at a time when close to a quarter of Americans are disproportionately and severely deprived of educational opportunity at colleges and universities.

There has been inadequate effort to integrate and restructure the system into a cohesive policy-driven program, despite the obvious benefits and cost savings. While the current system does benefit affluent students, the lending industry, and political objectives, it is both extraordinarily inefficient and ineffective with respect to key objectives such as higher education access, retention, and debt burden. It needs to be replaced with a strategically oriented, results-driven, and greatly simplified program of grants, loans, and tax benefits that demonstrably works to serve clearly articulated goals. As a consequence of both the inadequacy and complexity of existing financial aid programs, many economically disadvantaged students (and parents) no longer see higher education as an option open to them but rather as a privilege for the more affluent.

### What To Do?

The Spellings Commission offered several recommendations concerning the access and affordability of higher education:

Every student in the nation should have the opportunity to pursue postsecondary education. The Commission recommends, therefore, that the United States commit to an unprecedented effort to expand higher education access and success by improving student preparation and

persistence, addressing non-academic barriers and providing significant increases in aid to low-income students.

To address the escalating cost of a college education and the fiscal realities affecting government's ability to finance higher education in the long run, the Commission recommends that the entire student financial aid system be restructured and incentives put in place to improve the measurement and management of costs institutional productivity. The federal government, states and institutions should significantly increase need-based student aid.

To accomplish this, the present student financial aid system should be replaced with a strategically oriented, results-driven system built on the principles of (i) increased access, or enrollment in college by those students who would not otherwise be likely to attend, including non-traditional students; (ii) increased retention, or graduation by students who might not have been able to complete college due to the cost, (iii) decreased debt burden, and (iv) eliminating structural incentives for tuition inflation.

Federal grant programs should be consolidated to increase the purchasing power of the Pell Grant. Whatever restructuring of federal financial aid takes place, the Pell Grant will remain the core need-based program. Policymakers and higher education leaders should develop, at the institutional level, new and innovative means to control costs, improve productivity, and increase the supply of higher education. At the same time, the Commission opposes the imposition of price controls.

America must ensure that our citizens have access to high quality and affordable educational, learning, and training opportunities throughout their lives. The Commission recommends the development of a national strategy for lifelong learning that enables all citizens to prepare for and participate in higher education throughout their lives. Lifelong learning should be a right, not a privilege, if the United States is to sustain its economic competitiveness and national security.

#### A National Agenda for Higher Education in America

More generally, the future of higher education is of immense importance to the United States. The increasing dependence of our nation on advanced education, research, and innovation compel efforts to both sustain and enhance the quality of our colleges and universities. Yet, as this testimony suggests, the traditional structure for financing higher education in America may no longer be viable. Traditionally, this has involved a partnership among states, the federal government, and private citizens (the marketplace). In the past the states have shouldered the lion's share of the costs of public higher education through subsidies, which keep tuition low for students; the federal government has taken on the role of providing need-based aid and loan subsidies. Students and parents (and to a much lesser extent donors) pick up the rest of the tab.

Yet this system has become vulnerable as the states face the increasing Medicaid and retirement obligations of a growing and aging uninsured population, made even more difficult by the state tax-cutting policies during the boom period of the late 1990s. This is likely to worsen as a larger percentage of young people and working adults seek higher education while the tax-paying population ages and health care costs continue to escalate. As Kane and Orzag conclude, “the traditional model of higher education finance in the U.S. with large state subsidies to public higher education and modest means-tested grants and loans from the federal government is becoming increasingly untenable.” (Kane, 2003).

One might approach this as an appropriate challenge to the federal government. After all, in some ways it was federal inaction that created the current dilemma, crippling state budgets with unfunded federal mandates such as Medicaid, through federal inaction on national priorities such as universal health care, and shifting philosophies of federal financial aid programs. It is also the federal government’s responsibility to invest adequately in providing for economic prosperity and national security, particularly in the new flat world characterized by phenomena such as outsourcing and off-shoring characterizing a hypercompetitive, global, knowledge-driven economy increasingly dependent upon knowledge workers, research, and technological innovation. (Friedman, 2005).

Perhaps it would be more constructive, however, to present this as an opportunity: We have entered an age of knowledge in a global economy, in which educated people, the knowledge they produce, and the innovation and entrepreneurial skills they possess have become the keys to economic prosperity, social-well being, and national security. Moreover, education, knowledge,

innovation, and entrepreneurial skills have also become the primary determinants of one's personal standard of living and quality of life. Democratic societies—and state and federal governments—must accept the responsibility to provide all of their citizens with the educational and training opportunities they need, throughout their lives, whenever, wherever, and however they need it, at high quality and at affordable prices.

Put another way, it is imperative both as a matter of social justice and economic competitiveness that the nation, the states, and our colleges and universities address and remove those factors that have created an alarming dependence today of access and success in higher education upon socioeconomic status. America should aspire to the idea where family income is nearly irrelevant to the ability of a student to attend the college or universities best matched to his or her talents, objectives, and motivation.

Thank you for the opportunity to appear here today. I look forward to discussing these issues with you and the rest of the committee.

## References

- Duderstadt, James J. and Farris W. Womack, *The Future of the Public University in America: Beyond the Crossroads*. Baltimore: Johns Hopkins University Press, 2002.
- Friedman, Thomas. *The World Is Flat: A Brief History of the 21<sup>st</sup> Century*. New York: Farrar, Strauss, and Giroux, 2005.
- Haycock and Danette Gerald, *Engines of Inequality: Diminishing Equity in the Nation's Premier Public Universities* (Washington: Education Trust, 2006).
- Ikenberry, Stanley. "Uncertain and Unplanned: The Future of Public Higher Education". Policy Forum Vol. 17, No. 3, Institute of Government and Public Affairs, University of Illinois. Champaign: 2005
- Kane, Thomas and Peter R. Orzag. "Higher Education Spending: The Role of Medicaid and the Business Cycle". Brookings Institution Policy Brief, Washington, 2003.
- New York Times* Editorial, "Keeping the Public Colleges Afloat", (2004)
- The Secretary of Education's Commission on the Future of Higher Education in America, *A Test of Leadership: Charting the Future of U.S. Higher Education*, Washington, DC: Department of Education, 2006.
- PCSUM, "Tuition Cost Seen as 45% of Full Price." Lansing, MI: President's Council of State Universities of Michigan, November 2004.
- Selengo, Jeffrey. "The Disappearing State in Public Higher Education", *Chronicle of Higher Education*, February 28, 2003, A22-A24. Washington, 2003
- Winter, Greg, *New York Times*, 2004.
- SHEEO, State Higher Education Executive Officers letter to the National Commission on the Future of Higher Education, June 2, 2006
- Zemsky, Robert, William Massey, and Gregory Wegner. *Remaking the American University: Market-Smart and Mission Centered*. New York, 2005.

