Financing Higher Education in Postmodern Times

IHELG Monograph 92-6

(Introduction to Prepaid Tuition Plans: Problems and Promise, NY: College Board, 1993)

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University of Houston Law Center/Institute for Higher Education Law and Governance (IHELG)

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The UHLC/IHELG works in a series of concentric circles. At the core of the enterprise is the analytic study of postsecondary institutions—with special emphasis on the legal issues that affect colleges and universities. The next ring of the circle is made up of affiliated scholars whose research is in law and higher education as a field of study. Many scholars from all over the world have either spent time in residence, or have participated in Institute activities. Finally, many others from governmental agencies and legislative staff concerned with higher education participate in the activities of the Center. All IHELG monographs are available to a wide audience, at low cost.

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My admiration for TRIO and other student service professionals, always high, was renewed two years ago when I was asked to address an Upward Bound class in Madison, Wisconsin. (I was on leave that year at the University of Wisconsin Law School.) I addressed a restless group of middle school students, all of them Black, Latino, or Asian, on a Saturday afternoon—when all of us would have rather been somewhere else. I was giving a brief talk on what it takes to become a lawyer, the kind of talk most lawyers or other professionals can give at the drop of a hat. As I have in the dozens of such talks I have given, I tried to stress how hard work and a sense of purpose are essential to any career, whether one in law, teaching, music, or athletics. This prompted the usual questions about how much money lawyers made, a strong preoccupation among high school students, as well as how long it took to become an attorney. But when I made a pitch to avoid drugs, they perked up. Several reminded me that attorneys defended drug dealers. When I noted that anyone with a drug record might not be able to become a lawyer, one astute 13-year-old floored me with the question: "Is that juvis [juvenile records] or adult?" I was mortified, and while I considered myself pretty good on my feet, and no prude, I was struck by how college-going for minorities and low income kids is so much of a different world than college-going is for the affluent, even in predominantly white and prosperous
Madison. Imagine it in the Valley in Albuquerque, Watts, Fourth Ward in Houston, Pilsen in Chicago, the South Bronx--where the students are virtually certain not to know an attorney except through their own or a family member's involvement with a public defender. It's little wonder they aspire unrealistically to be an NBA star or rapper or other unlikely professional; if they are Latino, they have a better chance of playing in major league baseball than in becoming a law professor. (Fewer than 100 of the nearly 6,000 law professors are Latino, far fewer than the number of Latino professional baseball players.)

I relate this anecdote to show my admiration for TRIO-program professionals, to give a sense of their daunting task, and to set the context for an examination of financial aid practices, including prepaid tuition programs. In Part I, I review the background of recent federal developments in higher education legislation, particularly efforts to reach low income and minority families. This is a complex history, and although there is a small circle of higher education finance historians, it is a tale not told often or well. Part II concentrates upon the most recent development in state financing of higher education, prepaid tuition programs.

I. The Need for College Information:

Reflections on the College-Going Process

Almost any need-based college aid program will help minority students in the postsecondary system. The problem is that
financial aid and financial aid information is available only to those students already admitted into an institution. Three dimensions of the financial aid delivery system disproportionately discourage minority students, particularly blacks and Latinos, from seeking or achieving admission to colleges and universities. These include information inequities, negative consequences of system complexity, and institutional aid practices. To some extent, these issues affect all students, but they affect minority students most directly and detrimentally, because of the poverty of these communities, the structural features of our higher education system, and the historical racism that has characterized higher education in the United States.

Information inequities have a negative impact on minority communities, and particularly bilingual communities, which are dependent on different and less formal information systems than are majority populations. Studies of underparticipation by extremely poor families in social service programs, as a consequence, have attributed the low rates to poorly designed information delivery system.¹

These deficiencies in "getting the word out" crucially affect black and Hispanic populations. These students attend high schools where college aspirations are not the norm. It is likely that parents of high school minority students have not attended college--and in the case of Hispanics, are unlikely to have graduated from high school--so these parents, even those who desire college for their children, are not enmeshed in the social networks or alumni
recruiting efforts as college graduates. In many cases, the costs of college loom so large as to establish a folklore that college is completely impossible for their children: the expense of attending many colleges exceeds the annual wages of many minority families.

Of course, many institutions try hard to recruit, but the most successful recruiting efforts are those where student "merit" is measured by scores, either high test scores or high athletic scoring averages. National Merit Scholars or the graceful seven-footer are likely to come to the attention of many colleges, and fierce, often shameless, competition ensues for either type of high scorer. In fact, the NCAA has to fashion rules to limit recruiting for student athletes. We know how to recruit.

When institutions deem it important to recruit certain students, they mobilize resources and recruit as if their reputations demanded it. Once a school is effective in these pursuits, and develops a reputation for supporting its high-scorers, the information networks become more effective and far reaching. Alumni and counselors assist. Reputations are established and maintained. We've even solved "articulation problems," and coordinate the flow of athletes from junior colleges to senior programs. However, for the great mass of medium or low scorers, the word is simply not enough. I believe that institutions that want to recruit minority students can do so, but only with the long-term commitment and resources employed to establish information networks for attracting honors students and athletically talented students. Few institutions seem committed to
such a coordinated information campaign for recruiting and providing aid to minority students, and the poor numbers show the results.²

Complexity of financial assistance programs, which poses problems for even middle-class families, renders them virtually inaccessible to poor families. Anyone who has completed an income tax return (and many poor persons are not required to do so) realizes the degree of reading and arithmetic skills necessary for completing the forms, even if a standard deduction is used. Completing the necessary financial aid forms is even more complex than completing tax returns, and requires more calculation of assets, even for poor families who have few tangible assets, is a near-impossible task without assistance. Talent Search and other TRIO programs are woefully underfunded, with no prospects of improvement. Furthermore, federal efforts to ferret out fraud have made completing the forms more complicated yet.

In addition, few minority parents have the previous credit records with banks required to secure readily the information and assistance available for the variety of loans. Despite the extraordinary profits guaranteed the lending industry, little systematic effort has been made to simplify the paperwork or reach minority communities for responsible student loan assumption. In my view, the required aid counseling by financial aid offices is pro forma and not very useful. How could it be, given the overworked staff on most campuses?

The most detrimental consequence of system complexity,
however, is the most obvious: fewer poor people can afford college or its start-up costs. Application fees, test and transcript fees, form preparation expenses, and other related costs occur even before an application is complete and considered by a college. Some colleges allow or encourage videotaped applications from students, surely skewing the pool toward the advantaged. Poor families, even those who stumble upon available fee waivers, often lack the required sophistication for negotiating the high technology of college choice—assuming they even have a college in mind.

Institutional aid policies themselves pose the biggest problem for minority students and the most formidable barrier to financial assistance. One recent study found that, despite the poverty of Latino families, only 48% of Hispanic parents with high school seniors applied for financial aid, and, of those applying, only 63 percent received any financial aid award. If these findings are correct, it means that fewer than one-third of Hispanics requiring financial aid receive it.³

Another study, my own, uncovered an even more disturbing pattern: the small extent to which any financial aid packaging is being aimed at Hispanics.⁴ Over 60 percent of Hispanic freshmen received only one source of aid (a Pell Grant), and, where there was more than one source of aid, over 95 percent received a Pell Grant. Since Pell Grants are the cornerstone of federal financial aid policy, it is reassuring to have evidence that Hispanics are receiving this assistance. However, 60 percent of Hispanic
freshmen received only Pell Grants, and the grants cover only one half of the cost of attendance. Where are the students making up the difference? Alvin So, in a 1984 study, found that Hispanic parents, on average, received only 39 percent of the aid required to send their children to school.\textsuperscript{5} Data reveal that need-based aid is delivering more assistance to needier families, but little additional institutional aid in the form of grants or scholarships is being awarded to Hispanics.\textsuperscript{6} These findings reinforce the earlier point concerning institutional commitments: if institutions see minority students as "wards of the state" or as solely the government's responsibility, then none of the discretionary aid used to attract-high-scorers (on tests or on the playing fields) will be used to improve minority attendance.

Another problem is the tendency of minority students and parents to overreport annual income. I found in a recent study that most Hispanic students simply did not know how much their parents made, and that Hispanic parents substantially erred on the conservative side when called upon to complete aid forms.\textsuperscript{7} Only 21 percent of Hispanic freshmen accurately reported family income within $500 (a significant amount when over 70 percent of the families earned less than $10,500 in 1979); most interestingly, 56 percent overestimated, while only 22 percent underestimated. The most impoverished (those whose family incomes were less than $7,500) were far more likely to overestimate (60 percent) than to underestimate (6 percent).\textsuperscript{8}

The bulk of self-report literature and the increased federal
reporting requirements, however, are concerned with documenting the tendency of families to "shelter" or not to report income. This is a reasonable concern, to be sure, but a practice unlikely to occur in poor families, who have little to spend or shelter. Federal or institutional policies that would require IRS 1040 forms as income verification, however, will disproportionately affect low-income persons who often do not have either the resources or technical assistance to complete complex forms. Those in the lowest income brackets would be required to complete a 1040 form and verify eligibility even though they had no statutory requirement to file with the IRS.

The pronounced tendency for low-income families to overreport income does pose problems, though of a different sort than the problems imagined by those who have supported additional reporting requirements. For instance, overreporting income can lead to lower eligibility and aid awards (because aid deadlines occur before IRS deadlines or the end of the year, when a family knows how much it earned that year); this error would be compounded over the period of enrollment if it were not caught or corrected. In addition, many poor families, particularly in times of high unemployment, are unlikely to document income with the required specificity. Persons not regularly employed (who may do piecework, housecleaning, odd jobs, day-labor, agricultural work), or those whose employers do not keep regular or timely records will literally be unable to document income or assets. Lack of technical assistance to complete forms often means late, incomplete, or inaccurate
applications; many times, the needy families will otherwise not fit into computer profiles and their aid will be denied or delayed. Immigrant families may be hesitant to interact with complex bureaucracies that require detailed, personal information. Overextended aid offices are unlikely to offer adequate assistance, as merely keeping up with the correct and timely forms often overwhelms even the most well-run offices. Requirements that poverty be better documented are likely to dissuade many families, particularly minority families.

This parade of horrors should not be used to argue for the reduction of financial aid programs. That they do not work better is no reason to reduce or eliminate them. That they fail to ferret out all income fraud is no reason to impose paperwork requirements that will increase obstacles for low-income persons. Those minority students who do manage to negotiate the shoals seem to receive aid according to their need, at least if their self-help portion is not unreasonably high. On balance, the system works well, for those who get into the system.

This hedged endorsement, however, does not spare institutions of higher education, which are often their own worst enemies, from sharp criticism. Tolerating poorly administered and understaffed financial aid offices is a false and poor economy. Using discretionary institutional aid only for high scorers is a terrible mistake, as more and more schools will compete for fewer of these academic and athletic blue-chippers. Most importantly, however, institutions brought on the reduction proposals and Pell Grant
cutbacks themselves, by successfully inducing Congress to legislate the Middle Income Student Assistance Act of 1978. MISAA set off a round of tuition increases, played the wealthy off against the poor, and hastened the transfer of colleges costs from parents to the government. In this and other areas, higher education has been a victim of its own excess. Colleges must commit themselves to work for future aid policies which deliver the highest proportion of aid, with maximum accessibility and minimum red tape, to the low-income students who need it most. To do less will condemn these students, many of them very bright and capable, to asking, "Does that include juvis?"

II. State Prepaid Tuition Plans

In contrast to the longstanding traditions of loans, grants, and scholarships, state financing of higher education by prepaid tuition plans has a more recent history. Although Michigan was the first state to enact legislation for a plan, Wyoming actually sold the first contract, in 1986. Since 1986, six states have formed prepaid programs (Alabama, Alaska, Florida, Michigan, Ohio, and Wyoming), while Pennsylvania has the enabling legislation on the books and is seeking vendors for a 1993 startup. Kentucky has a hybrid educational savings account program with an endowment component. The Michigan Educational Trust program is on hold, due to extensive public criticism and an adverse tax determination. Therefore, eight states have prepaid tuition programs with guaranteed tuition components, but even these eight are fluid.
Florida's Prepaid Postsecondary Education Expense Program is the clear frontrunner of the genre, and in its four years has sold nearly 200,000 contracts.

Many more states have moved to enact educational savings plans, either by stand-alone bond issues or by earmarking a higher education portion of larger, general obligation bond issues. To list these plans is an even more fluid task, as several states with authority (e.g., Louisiana) never issued more than one set of education bonds, and other states with authority (e.g., Indiana and Minnesota) changed their minds and never promulgated regulations or developed full-fledged programs. Maine repealed its enabling legislation. In contrast, Connecticut has become the Florida of education bond programs, issuing general obligation bonds every 6 months for the last 5 years -- totalling nearly one billion dollars. In Indiana, individual public institutions issued their own bonds.

Although virtually all of the two dozen states with bond programs have "Education," "College," or "Trustee" in their statutory language, bond purchasers need not necessarily use the money for college expenses. For example, while Connecticut refuses to sell bonds to institutional purchasers, the private individuals who do purchase the bonds are not required to spend the money on higher education; they need not have college-aged beneficiaries; and they need not reside in the state. Some states allow institutional investors to purchase bonds in large quantities for investment portfolio purposes, while other states have engaged in
more commercial, consumer-oriented programs. Connecticut is the premier example, with an 800-phone number, over 60 outlets for purchasing bonds, and a sophisticated and extensive public relations and marketing program: every school child and licensed motorist receives sales notices in the state. [insert Tables 1 and 2]

When one totals these programs and adds the federal Series EE Bonds and private sector initiatives (e.g., The College Savings Bank, of Princeton, NJ), it is incontestable that many means for financing higher education exist outside the traditional federal assistance programs of the Higher Education Act, Title IV.

Indeed, the avowed aim of some of these plans appears to be a stimulation of parental savings for their children's education. Janet S. Hansen, whose careful scholarship on federal financial aid issues has made her authoritative on this topic, summarized in an earlier book on prepaid tuition programs:

One of the major current disagreements among economists over whether governments should enact policies to increase families savings for college has to do with the nation's declining rate of savings and whether past efforts to encourage saving did much to change behavior. There is little consensus about whether financial incentives encourage increased saving or only cause savers to shift their funds from one kind of saving instruments to another. The 1980s saw high real interest rates, lower tax rates on income, and special incentives for saving—in sum, a very positive climate for savers. Yet the personal savings rate dropped. This history should make policymakers cautious about thinking that they can dramatically affect family behavior by adding this or that feature to a college savings plan.\[10\]

Hansen wrote this at a time when the real estate market was
booming, when the stock market was at historic levels, when rates of return on savings were high, and when capital gains taxes had been lowered. The political questions become more sharply defined in hard financial times, both at the federal level and in state-based programs. Moreover, the generally bleak economic situation excacerbates the information needs, as I noted earlier. If poor communities already lack consumer information and fear the cost of college going for their children, news stories about rising college prices and a dynamic marketplace of subsidized financing options will likely increase the college attendance gap between the poor and the wealthy.

It is for good reason that Paul Horvitz considers the psychology of savings programs, as well as the more traditional finance and political issues. His paper clearly sets out the competing finance theories at play in this field, weighing each for its equity and efficiency consequences. After balancing the effects of various state proposals, he concludes that the true principle behind prepaid tuition plans is the maintenance of relatively low tuition levels, ones that favor the wealthy—who are disproportionately more likely to attend college and consume the benefit. He finds this rationale to be a "weak reed on which to base a major government program."

Professor Jeffrey Lehman, one of the early and most prominent scholars in the area of prepaid tuition plans, has followed up his influential 1990 *Michigan Law Review* article, "Social Irresponsibility, Actuarial Assumptions, and Wealth Distribution:
Lessons About Public Policy from a Prepaid Tuition Program," with a careful study of the Michigan Education Trust's (MET) decision to expand its subscriber base by offering a Monthly Payment Option. In his earlier critique, Professor Lehman had charted the redistribution of state subsidy benefits upwards to the most advantaged Michigan residents. Partially in reaction to this criticism, the MET board in 1990 changed its way of selling contracts to allow purchasers to spread out the payments over a period of time; it was anticipated that this would permit families with lower incomes to participate, especially since the size of monthly payments is often more salient to low income consumers than is the total obligation.

His data show that the availability of purchasing monthly options reduced the "skewedness" of the original MET purchaser profiles, but not by a substantial margin, and measurement considerations between the two periods make comparisons difficult. To counter this distributional effect, Lehman suggests a sliding-scale price approach, presumably a means-tested methodology that would not more heavily subsidize the wealthier purchasers. Of course, the federal mechanism for sliding-scale parental contributions is itself a political act, caught in a tug of war between Congress and the Secretary of Education, and its theoretical simplicity predictably bogs down in the political details. For example, treatment of home equity or farm ownership can make an extraordinary difference in federal financial aid eligibility.\textsuperscript{11} At the state level, I suggested several years ago
that states consider sliding-scale subsidization for treating postsecondary residency, but this dog has not hunted.¹²

William Montjoy, an attorney who directs the successful Florida program, counters the more critical analysis offered by Professor Lehman and other researchers. In truth, Florida has avoided many of the administrative and political problems that Michigan has faced or created in its MET program, such as not discounting its contracts. Indeed, he concedes that it may be possible and appropriate to charge higher amounts for the contracts. This feature could dovetail with Lehman’s sliding scale proposal, tied to the purchasers’ income, their own college attendance history (by favoring children whose parents did not attend college), or other criteria. He acknowledges that the idea of a plan is to stimulate savings, and he is certainly correct when he argues that public confidence in the plan’s efficacy is essential. He does not add that being in a state with a booming population helps, although it appears clear that Florida’s demographics and actuariais are better than the industrial-belt Michigan’s could be.

David Williams, II, a leading tax scholar, has carefully reviewed the tax consequences of college savings plans and offers the first published scholarship on the Summer, 1992 tax ruling case in Michigan, which is the coup de grace for the MET program unless it is substantially overhauled. Although the tax consequences of all postsecondary plans are substantial, they differ greatly in the details and family circumstances of the purchasers. Professor
Williams' work clearly sets out these details, and persuasively argues that parents should consider investing in a variety of the available options.

The final chapter is the most technical of the book, but its analysis is easily the most crucial to the success of prepaid tuition programs. Unless the states are politically willing, within the tax laws, to underwrite any shortfalls, these programs have to stand on their own bottom, or operate out of their own pooled resources. Of course, this means undertaking an investment strategy that approximates or betterers the college costs of the future. As Lewis Spellman shows, real total returns on long-term government debt instruments were lower than the tuition inflation rate in 2/3 of the years between 1966 and 1987, and this in a time of substantial economic growth in the country.

As Professor Spellman notes, this uneven performance is in part due to the pattern of college tuition costs averaging nearly 3% more each year than the Consumer Price Index (in 1992-93, the College Board price figures were seen as newsworthy because the increases of 6 to 10% were "not as large as expected"), and in part due to the tendency of trust portfolios to invest in "safe," government debt instruments tied to long term rates. Recent low interest rates and rising college costs -- even if they are increasing at a lower rate than expected -- could spell obvious disaster for guaranteed tuition plans. Like Professor Horvitz, who saw the psychological aspects of parents or other purchasers investing in college contracts, Professor Spellman sees
psychological resistance by traditional government investor
gencies and communities (who may have lucrative arrangements under
the current investing regimes), and a psychological dimension, what
he calls a "reputational capital" feature, in the market.
Notwithstanding his pessimistic assessment of current investment
behavior, he sees a silver lining in the clouds, noting that the
time is ripe for inflation-adjusted finance mechanisms, as
"inflation is currently not seen as an overwhelming or visceral
threat."

These papers are a substantial contribution to the debate over
the equity and efficiency of prepaid tuition plans, and an advance
over the first generation of scholarship in this important area.
While the first articles in the topic are of recent vintage,
appearing only five or six years ago, everyone knows more now. In
addition to the increasing scholarship (and its growing
interdisciplinary sophistication), there are hundreds of thousands
of contracts being purchased and executed for beneficiary students.
Prepaid plans, both public and private, have earned a place in the
investment portfolios of parents, and it is safe to say they will
increase and prosper if they earn the trust of parent-investors and
legislators. The failed MET experiment could be salvaged, and a
reconstituted program could well appear. Its greatest legacy, like
San Francisco's BART subway system, may turn out to be its
innovation and precocity, even its mistakes showing others how to
proceed in a bold legislative laboratory.


5. So, Table 1.


9. Douglas Windham has carefully investigated the purported evidence of widespread fraud and found most of the "abuses" to be nonexistent or minor. He concludes that the government's campaign in this area was a smokescreen for rolling back aid limits. See "Federal Financial Aid Policy: The Case of the Pell Grant Quality Control Study," *Review of Higher Education* 4 (1984): 397-410.


Table 1
State Prepaid Tuition Programs


1 Inactive or suspended operation
2 Not yet operational
3 Several state institutions administer their own programs
4 Combined prepaid tuition fund and savings plan trust
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<th>Program</th>
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<tr>
<td>Arkansas College Savings General Obligation Bonds(^1)</td>
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<tr>
<td>California Savings Bond Program(^1)</td>
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<tr>
<td>Connecticut College Savings Bond Program(^1)</td>
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<td>Delaware(^1)</td>
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<td>Hawaii(^1)</td>
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<tr>
<td>Illinois College Savings Bonds(^1)</td>
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<td>Indiana College Savings Bonds(^1)</td>
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<tr>
<td>Iowa College Super Savings Plan(^1)</td>
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<tr>
<td>Kentucky Educational Savings Plan Trust Act(^2)</td>
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<tr>
<td>Louisiana Education Tuition and Savings Plan(^3)</td>
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<tr>
<td>Michigan Education Trust(^4)</td>
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<tr>
<td>Minnesota(^4)</td>
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<tr>
<td>Missouri College Savings Bond(^3)</td>
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<tr>
<td>New Hampshire College Savings Bonds(^1)</td>
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<tr>
<td>North Carolina Capital Appreciation Bond Program(^1)</td>
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<td>North Dakota Educational Bonds for Savings Program(^1)</td>
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<td>Ohio College Savings Program(^3)</td>
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<td>Oregon Baccalaureate Bond Program(^1)</td>
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<td>Rhode Island College and University Savings Bond Program(^1)</td>
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<td>South Dakota Education Savings Program(^1)</td>
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<td>Tennessee Baccalaureate Education Savings Program(^1)</td>
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<td>Texas College Savings Bond Program(^1)</td>
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<td>Virginia Tuition Savings Program(^1)</td>
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<tr>
<td>Washington College Savings Bond Program(^1)</td>
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<td>Wisconsin Higher Education Bond Program(^1)</td>
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</table>

\(^1\) Savings bonds or earmarked general obligation bonds

\(^2\) Combined trust fund and prepaid endowment fund

\(^3\) Combined education savings program and guaranteed tuition plan

\(^4\) Inactive or suspended operation