Senate Committee on Finance
U.S. Senator Orrin Hatch (R-UT), Ranking Member
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HATCH STATEMENT AT FINANCE COMMITTEE HEARING EXAMINING THE ROLE OF EDUCATION INCENTIVES IN THE U.S. TAX CODE

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today released the following opening statement at a committee hearing examining the role of education incentives in the U.S. tax code:

The focus of today's hearing is a narrow, but very important, one – the role of education incentives in our tax code. Traditionally, the federal government has supported millions of individuals seeking higher education through grants and loans. Over the last 15 years, however, federal support for higher education has increasingly relied on incentives in the tax code.

These education tax incentives can generally be classified into one of three categories.

The first category includes tax incentives for current expenditures for higher education. These incentives include the Hope, American Opportunity and Lifetime Learning Credits; a deduction for higher education expenses; and the exclusion for scholarships and fellowships. The second category includes tax incentives for student loans. These incentives include the deduction for interest paid on student loans and the exclusion from income for certain student loans that have been forgiven. The third category includes tax incentives for savings for college. These incentives include qualified tuition plans, generally referred to as 529 plans; Coverdell plans; education savings bonds; and IRA withdrawals to pay for college expenses without penalty.

Generally, two reasons have been given for the various education tax incentives. First, college education costs are increasing and are a barrier to entry for those who cannot afford the costs. Second, college education is a good investment that produces external benefits sometimes referred to as positive externalities.

According to the National Center for Education Statistics, the cost of college education for the 2009-10 academic year -- annual prices for undergraduate tuition, room and board -- were estimated to be $12,804 at public institutions and $32,184 at private institutions. Between 1999-2000 and 2009-10, costs for undergraduate tuition, room and board at public institutions rose 37 percent, and costs at private institutions rose 25 percent, after adjustment for inflation.

The high cost of a college education does create a barrier to entry. However, some portion of the barrier is alleviated by the U.S. Department of Education's Direct Loan Program (such as Stafford Loans), Federal Perkins Loans, Federal Work Study, Federal Supplemental Educational Opportunity Grants and the Federal Grant Program (such as Pell Grants) for lower income students. In fact, according to the John William Pope Center for Higher Education Policy, of the 16.4 million undergraduate students enrolled in college in the United States in 2010, approximately 58 percent or 9.6 million students received Pell Grants.

As to the external benefits of a college education -- some benefits from higher education may benefit not just the individual student in the form of higher wages, but also society as a whole. Since these external benefits may not be considered by individual students when considering higher education, individuals may invest less in higher education than is optimal for society. Providing educational tax incentives may induce potential students to enroll in higher education, increasing investment in education, and thereby creating external benefits.

A frank conversation about these incentives must also consider whether Congress is encouraging a higher education bubble. Are these incentives encouraging students to take on more debt and degrees than is warranted by the economic and professional gain these students are likely to realize from their educational achievements?

In evaluating the education tax incentives, we use the same three factors that are used in evaluating all tax incentives: equity, efficiency and simplicity. Some critical questions in evaluating education tax incentives are whether federal subsidization of higher education is good policy and whether a tax subsidy would be provided more efficiently by direct spending.

In 1987, then Secretary of Education William Bennett stated that in the long run, Federal financial aid programs lead to higher tuition as colleges capture some of the Federal aid to students. Some studies have shown some evidence of the *Bennett hypothesis*. I would be interested to hear from our witnesses if they believe the Bennett hypothesis applies to Federal student aid in the form of education incentives in the tax code. In other words, do colleges and universities capture the financial benefits of education tax incentives at the expense of eligible students and families? One recent economic paper indicates that is the case.

As to simplicity, one noted tax scholar, Michael Graetz, has written, "The education tax incentives represent the greatest increase in federal funding for higher education since the GI Bill. But no one can tell you what they are, how they work, or how they interact. Planning to pay for college around these tax breaks is essentially impossible for middle-income families." I think there is a lot of agreement that the education tax incentives are very complex and, at a minimum, should be consolidated and reformed.

We have a very distinguished panel with us today. I look forward to hearing what they have to say.

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