EDUCATION TAX PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

MARCH 3, 1999



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EDUCATION TAX PROPOSALS

WEDNESDAY, MARCH 3, 1999

U.S. SENATE, COMMITTEE ON FINANCE, Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Grassley, Hatch, Nickles, Mack, Moynihan, Baucus, Conrad, Graham, and Robb.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FI-NANCE

The CHAIRMAN. The committee will please be in order.

I want to welcome everyone here for the Finance Committee's hearing on education tax incentives.* We have a very, very full list of witnesses today, and it is already 10:00. We have five Senators who would like to testify, and then we have two panels, so I am going to ask the Senators to keep their comments to three minutes each.

I have a statement, but, rather than read it, in the interests of saving time, I would ask that it be incorporated as if read.

I call upon Senator Moynihan.

[The prepared statement of Chairman Roth appears in the ap-

pendix.]

Senator MOYNIHAN. Mr. Chairman, our colleague, Senator Baucus, has to necessarily leave, and perhaps I could yield to him.

The CHAIRMAN. Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. I thank you, Mr. Chairman. I will be very brief

because I know we have much work ahead of us.

Mr. Chairman, two weeks ago I had the honor of addressing the Montana State legislature. When I spoke, I told that body, because I believe it very deeply, that the time has come to bring the promise of world-class education to every Montanan, full stop, simple, period. I believe in that statement, and I believe it deeply. I think most Americans do.

^{*}For further information on this subject see also "Overview of Present Law & Issues Relating to Tax and Savings Incentives for Education," Joint Committee on Taxation staff report, March 2, 1999 (JCX-12-99).

Mr. Chairman, we are the stewards of our children's learning. Our future as a Nation depends on our willingness to invest in them, in our teachers, in our schools all across our land. We have a moral responsibility to leave this Nation's children as prepared, if not better prepared, than our parents left for us. It is as simple as that.

That challenges takes a unique form when we talk about meeting the needs of rural States like mine. Mr. Chairman, I might say that when I worked at one school in Montana, I found that the nearest library to one school is 30 miles away, and Internet access,

as we know, is very critical to our students.

Nearly 40 percent of the kids that go to school in America every day go to a rural school, in a small town. Forty percent. Yet, somehow we as a Nation invest only 22 percent of our total education funding on these students, half of what we spend on non-rural kids.

In 1997, I conducted a survey of Montana schools. And I mention Montana because I think it is somewhat representative of other thinly-populated States. I asked questions about technology, about the availability of computers, Internet hook-up, et cetera. I found, as one might expect, that the results show that rural schools just don't have the access, don't have the computers, don't have the wherewithal that other children have.

In the interest of time, Mr. Chairman, I will not go through all the details. But I want to say, and say this very strongly, that for too long we in the Congress have equated need with size. Our urban areas have their very special problems. We must address

them. Very visible problems.

They get, I might say, a disproportionate amount of help because their problems are so visible. That is not as true with rural education. Their problems are severe, but they are not as visible. TV does not cover them. They are not on the evening news. They are harder to get to. They are unique, special problems. I just want my colleagues to know that I will do my part to assure that schools all across our country get top-quality, first-class attention. It is clear that is where the future is, for our kids, for our Nation.

I just commend you, Mr. Chairman, for holding this hearing. I know my colleagues who are witnesses believe in the same vision. This is a great opportunity for us in America. I am really excited about it, that we can make our country very strong and, as we enter the next century, we can be very, very, very well prepared. When we look back, we will be very proud of some of the things

that we have done.

Thank you, Mr. Chairman.

The CHAIRMAN. I would say to my distinguished colleague that quality education is important to all Americans, wherever they live, whether it is rural, urban, or whatever. That is the purpose of this hearing today, is to try to develop legislation that will create the kind of policies that will enable all young Americans to have that quality education.

Now, I am going to ask the rest of the committee, if they have opening statements, to please submit them, because I do want to

turn to the Senators in front.

I will start with Senator Coverdell.

STATÈMENT OF HON. PAUL COVERDELL, A U.S. SENATOR FROM GEORGIA

Senator COVERDELL. Well, thank you, Mr. Chairman and members of the Finance Committee. I appreciate the opportunity to be with you today and would ask that my full statement be submitted for the record.

The CHAIRMAN. The full statement of all Senators will be in-

cluded as if read.

[The prepared statement of Senator Coverdell appears in the ap-

pendix.]

Senator COVERDELL. Mr. Chairman, the proposal I speak to the committee about is not unfamiliar to the committee, nor the Senate, nor the Nation, for the matter. It is about the Education Savings Account, which was passed by a bipartisan majority in the Senate and the House and, regrettably, vetoed last year by the President of the United States.

My co-sponsor, I think, Senator Torcelli, has said it best. He said, it is not a question of whether or not this will become a part of the law of the land, it is only a question of when. And I think he is right.

In my limited time here, let me just highlight a few of the unique features of this Education Savings Account which would be for fam-

ilies to help their children kindergarten through college.

It is amazing to me how small things make Americans do big things. This allows them to save up to \$2,000 per year, and the build-up would not be taxed. That is not a lot of tax relief. Over a 5-year period, it is about \$800 million. But during that same period of time, about 10 million families would save nearly \$6 billion.

It would be the largest single infusion of new money into education in contemporary history, and the government would not

have had to have raised a dime.

One of the unique features of the account is that it can have donor support of the account. That is not calculated into the \$6 billion, that is only what the families would do.

What I am saying here is, a union, a corporation, a neighbor, an uncle, a grandparent, an interested friend, could also participate in

the savings account that would accrue to a child's interest.

I call these dollars very smart dollars because they are laser-guided to the child's problem. They are being directed. It's not brick and mortar, it's going to the physical need or lack of a home computer, the need of a tutor for math, whatever. So it is very smart money that gets right to the target.

I will close by simply saying that everyone wins in this, families that are in public schools, private schools, or home schools. I happen to believe that public schools are the largest winner because 70 percent of the families would be in public schools, and public

school teachers because they would be the tutors.

But everything wins, private, parochial, home, or public. I would hope that the 106th Congress will once again rally to something that is supported by almost 70 percent of our Nation. We would demonstrate, again, our unique interest in allowing families and their friends and associates to help guide to the better education Senator Baucus calls for.

I thank the committee for this opportunity.

The CHAIRMAN. I thank the Senator for his leadership on educational matters.

Senator Graham?

STATEMENT OF HON. BOB GRAHAM, A U.S. SENATOR FROM FLORIDA

Senator GRAHAM. Thank you, Mr. Chairman and members of the committee. I, too, will file my formal statement and use my three minutes to summarize.

I think there is a common theme that you are going to hear from all four of us, and that is the theme of increasing choice. That, in education, as in most things, the idea that there is one set of policy that fits all Americans is doomed for failure. Given the diversity of our peoples, the diversity of educational circumstances, that what we ought to be providing for our people are a range of options from which they can select.

One of those relates to an area in which the Federal Government has had a long interest, and that is providing increased access to post-secondary education. Senator McConnell and I have been working for several years on increasing the desirability of Statebased prepaid college tuition plans by making them fully tax-ex-

empt for Federal tax purposes.

With the assistance of yourself, Mr. Chairman, and other members of this committee, we accomplished a substantial amount of that a couple of years ago. But we still have one part to go, and I hope that we can get that final chapter completed at this session of the Congress.

Senator Sessions is going to be talking about further expansion of that concept to private colleges and universities. I will defer the

details of those discussions to my colleagues.

I would like to talk about another area of choice, and that is what would be a relatively new field for Federal involvement, and

that is in public school capital construction.

The Federal Government has had a long tradition of providing assistance to post-secondary institutions for their capital needs, and we are also providing assistance to private kindergarten through 12th grade institutions.

This proposal is to expand the options for a public school or a State in its construction program. I am proposing, with Senator Grassley and others, four new Federal initiatives, or expansions of

existing initiatives.

One of those, is the private activity bond. Today, private activity bonds are used for airports, seaports, waste treatment facilities, private K-12 educational institutions, and a number of other pri-

vate/public partnerships.

We are proposing to allow this to now be used for private/public partnerships in the public school construction sector. And you are going to hear later today from Mr. Octavio Visiedo, the former superintendent of Miami Dade Public Schools, who is now working with a private firm in developing educational facilities.

We also are proposing to raise the arbitrage limit, which currently is \$10 million, to \$15 million, to expand the period of time for the arbitrage exemption from two years to 4 years, and, fourth, to allow school construction to be a bank-qualified bond exemption

which would permit investment in educational bonds by commercial banks. We believe that these are illustrative of the kind of expanded choices that should be made available by the Federal Government to meet our Nation's school construction challenge.

Thank you.

The CHAIRMAN. Thank you, Bob. Now we will let you come up on the panel and ask questions.

[The prepared statement of Senator Graham appears in the ap-

pendix.1

The CHAIRMAN. Senator McConnell.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Senator McConnell. Thank you, Mr. Chairman. You have a serious bill here. I like the way you run this committee. I have enjoyed my association with Senator Graham on this whole question

of the college savings accounts.

As he indicated, we have sort of been picking our way in the direction of complete tax freedom. In 1996, as part of the Small Business Job Protection Act, we were able to eliminate the tax burden on States that administer these State-sponsored college savings programs, and to shift the tax burden from the parent to the student. Typically, students do not have much of a tax burden, so that was moving in the right direction.

In 1997, Mr. Chairman, you graciously included in the Taxpayer Relief Act the ability to expand the tax-deferred treatment to include room and board costs, which typically can constitute, for many students and their families, up to 50 percent of the burden.

So what we are hoping this year, Mr. Chairman, is that we will complete the job and make this whole transaction completely tax free, not only the build-up and the expansion of benefits, but also when the money is taken out by the student, this whole transaction will be tax free.

We are all sort of dealing with different aspects of the same problem here, which is to try to help our families to be able to finance the ever-expanding burden of education. We thank you for what you are doing here and we hope that all of these great ideas will be incorporated in your final product.

So, Mr. Chairman, I would like to set a record here for brevity and ask that my full statement be made a part of the record.

Thank you for the opportunity to be here.

The CHAIRMAN. Well, we thank you for being here. Your full statement will be included as if read, but we will not ask you to join the panel to ask questions.

Thanks very much, Mitch.

[The prepared statement of Senator McConnell appears in the appendix.]

The CHAIRMAN. Now, Senator Sessions.

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM ALABAMA

Senator SESSIONS. Thank you, Mr. Chairman. I have had in the last, I believe, 8 years, two children to graduate from college, and one still in college.

The CHAIRMAN. I have the same problem, I might say. Go ahead. Senator MOYNIHAN. You have medical school, do you not?

The CHAIRMAN. I have medical school. That is worse yet. [Laugh-

Senator SESSIONS. That is worse yet.

It is a reality check. Americans are struggling to pay for college education. In the last 10 years, we accrued more debt for college education than we did in the previous 30 years, so we know that

is happening to a large degree.

Why is that happening? I believe public policy in America should encourage our highest and best acts as American people. We are subsidizing debt. We give out guaranteed loans, we have PEL grants, and other efforts to fund it on that end. But we are taxing parents who choose to save. So, anyway, I think that is the wrong thing. I think we ought to encourage people to save, and to not tax them when they do.

So that is the fundamental premise behind this. Forty-two States now have prepaid college tuition plans, or will by the year 2000. Alabama has had one for a number of years. It is very popular.

What we would like to do is encourage people to contribute to those plans. This proposal that I have submitted and Senator Graham has co-sponsored has been supported by the American Council on Education, the largest group of colleges and universities. The National Association of Independent Colleges, the Virginia Prepaid College Tuition Plan, and other plans are supporting it.

We believe it makes good sense. With regard to private colleges, we believe they ought to be in the same position primarily because this is much more akin to a GI bill, much more akin to guaranteed student loans, or PEL grants that go to whether you go to private school or not. To give somebody a tax break only to go to a public

college seems to me just unfair.

Our bill does delay private colleges' participation for, I believe, 4 years before it starts, but I think the combination of being able to lock in a tuition rate under these college prepaid plans, plus being able to save without tax consequences, would encourage substantially the good behavior of saving and would save money on the back end in terms of grants and loans. I would notice that the Joint Tax score for this bill over the first 5 years would be only \$197 million in consequences.

Mr. Chairman, thank you for your attention. I know you favor saving, encouraging savings for America. This would also have the

benefit of encouraging saving.

[The prepared statement of Senator Sessions appears in the ap-

pendix.]

The CHAIRMAN. Thank you, Senator Sessions. I want to express my appreciation to all of you for being here this morning. Not only do I favor savings, but I am very strongly in favor of making sure that all young people have the opportunity to go to college. I think this legislation is one step in that direction.

So, we look forward to working with you. We know you are busy. We appreciate your being here, and we shall work with you as this legislation moves along the legislative path. Thank you very much.

It is now my pleasure to call forward the first panel, which consists of four witnesses. These witnesses have all had some experi-

ence with the current tax incentives for education.

They will explain the importance of the provisions in helping American families afford a quality education, and at the same time they will point out some of the deficiencies, and will suggest some changes to make them even more helpful. So I am very please to call them up.

Our first witness will be Esthelda Parker-Selby. Ms. Parker-Selby is both a parent and an educator. Besides putting two children through college, she is a principal at an elementary school. Most importantly, she is from Delaware. I have to warn you right now, Pat, this is Delaware day. She serves on the Delaware Higher Education Commission.

Senator MOYNIHAN. Sir, may I point out that we live in Delaware County. That is where you reside.

The CHAIRMAN. I am appreciative of that fact.

Senator MOYNIHAN. Named for Lord Delaware. Are you aware of

The CHAIRMAN. Who was not the original one. The recent one

was a very close friend of mine.

But Ms. Parker-Selby serves on the Delaware Higher Education

Commission.

Next, I would like to call forward James T. McCarthy, who is a vice president for Tax Product Development at Merrill Lynch. He has the responsibility for overseeing the Education IRA and other college savings plans at Merrill Lynch.

The other two witnesses on the panel will discuss employer-provided education assistance, something of great interest to you, Sen-

ator Movnihan.

Senator MOYNIHAN. To us.

The CHAIRMAN. To us. That is absolutely correct. This educational assistance is also known by its location in the Internal Revenue Code, Section 127.

Alexis Garland is a procurement coordinator for Hewlett-Packard. I am proud to say she is also from Delaware. She has taken advantage of employer-provided educational assistance, receiving a

degree and also moving up at Hewlett Packard.

Shirley Hughes is the senior vice president for Human Resources at Ceridian Corporation, and is speaking on behalf of the National Association of Manufacturers and the Section 127 Coalition. Ms. Hughes will describe the importance of this program and how it affects her ability to attract and retain quality employees.

So now it is my great pleasure to call upon Ms. Parker-Selby for

her testimony.

STATEMENT OF ESTHELDA R. PARKER-SELBY, PRINCIPAL, REHOBOTH ELEMENTARY SCHOOL, MILTON, DE

Ms. PARKER-SELBY. Good morning, Senator Roth and members of the committee, ladies and gentlemen. My name is Esthelda Parker-Selby and I am a native Delawarean who grew up, and presently resides, in Milton, Delaware, a little, small town.

I am honored and pleased to have been asked to participate in today's session focused on education tax incentives, and I also thank you for the opportunity.

As a single parent who is currently assisting my youngest son through college, I must admit that it has been a struggle making

sure all educational and financial needs have been met.

Due to many obstacles that have interrupted my life and my career, I was unable to have a substantial amount of money saved for my children's education. Therefore, I have not been a loan-free parent, nor has my family. Relatives have been very helpful in giving spending change and purchasing books, but the tuition costs have been my sole responsibility.

Historically, my family has attended schools in Delaware. I attended Delaware State University and the University of Delaware. My oldest son, and now the youngest, have also attended Delaware State University. Although in-State schools have a lower tuition fee allowed to in-State students, the struggle has remained to pay the

costs the best way possible.

I have had to borrow college fees the entire tenure of my sons' college attendance. Fortunately, I have had a sufficient salary and a credit history that allowed me to borrow the necessary funds.

I know of many people in Delaware who have not been able to meet the criteria to borrow and their children have had to wait a

year and work for tuition fees, or not attend college at all.

I can think of a case close to me where a mother came to me seeking information on how she could get financial assistance to help her daughter return to school. Her daughter needed only \$500. The point here, is that it was very difficult for many people to afford the costs to get their children education, and they need to know how to help themselves and get help.

With the rising cost of a college education, citizens across our country will continue to face the need to get financial assistance. Therefore, I am sure I can speak to families, regardless of their so-cioeconomic needs, when I say we need and want tax incentive

plans that consider our varied needs.

I am a member of the Delaware Higher Education Commission and we recently introduced the Delaware College Investment Plan through Fidelity Investments. The plan is catching on slowly, and more people are investigating the benefits and opting to try it.

I have discussed this plan and concept with co-workers, friends, and family and they have all agreed that people need to be able to start early to save for college and realize some tax incentive ben-

efits, or have tax-free benefits.

In my conversations, I kept hearing the words "clarity, benefits, affordability, and accessibility." We all feel that education tax incentive plans are necessary and that all families should be able to

benefit from them.

We feel that, whatever plans are adopted, the explanation of the plans should be clearly defined and explain why and how they can benefit a family's future needs. Plans that are adopted must be affordable and accessible to all who are interested in participating. There was discussion that any help through these plans that could decrease the tax burden or not have taxes on families would be greatly appreciated.

Overall, I am reminded of the wise words of Benjamin Franklin when he said, "If you empty your purse into your head, no one can take it away from you." Investment in knowledge always pays the best interest.

I have said a few things here and in my formal statement. I just would like to add that my parents were Depression people who grew up, and they were able to save and I was not, as a person from the 1960s. It was much more difficult, and for my children to save. So I have had to borrow.

Everyone I have spoken with is really not clear on what these plans are, how they operate, but they are very interested. And these are people who are educators that I work with every day.

I had lots of conversations this week prior to coming and it amazes me to know that educators are not aware of what is out there, as well as people in lower income brackets who want their children educated but basically cannot afford to even begin to save, possibly, or not know how.

So in some kind of way, there may be a need for us to get some kind of mass media campaign going on to let people become more aware of these programs that are out there and available for us.

I think that is all I am going to say right now. Thank you.

The CHAIRMAN. Well, thank you. Let me underscore what you are saying. I thought it was interesting. You said that your parents were able to save, but you were not.

Ms. Parker-Selby. Yes.

The CHAIRMAN. And let me point out what has happened in education. According to the latest figures from the College Board, in the last 10 years, the tuition at a 4-year private institution, even adjusted for inflation, has risen 40 percent, and the tuition at a 4-year public institution has risen 50 percent. Meanwhile, the median family income, adjusted for inflation, has risen only 1.5 percent in the same period. I think that sort of underscores what you were saving.

According to financial planners, if a child is 10 today, it is estimated that 4 years of schooling will cost anywhere from \$61,000that is a lot of money—in a low-cost State school to \$238,859—I do

not know what the cents are—in a top-tier, private school.

So I think it makes your message very clear.

Ms. PARKER-SELBY. If I may also add that I am a grandparent of five grandchildren, and I am also looking into how I can help my son and grandchildren. These type of plans are being investigated by me, and I am certainly interested. But I kind of want tax-free things. I am getting close to retirement.

The CHAIRMAN. Well, thank you. Senator ROBB. Mr. Chairman?

The CHAIRMAN, Yes?

Senator ROBB. Mr. Chairman, excuse me just one second. I regret that I am not going to be able to remain for the entire session. I hope to be able to get back. But I wonder if I could ask unanimous consent to put a statement in the record, and say that I have enjoyed the opening of Delaware Day and I commend you for holding it for the benefit of all of us. I certainly share your interest in both education and saving, and some of the ways that we can incorporate public policy to effect both of those fine and laudable goals.

The CHAIRMAN. I appreciate that, Senator Robb. We hope you are able to return. I know you will be very active as we proceed with this legislation in the committee and on the floor.

Senator ROBB. Thank you, Mr. Chairman.

[The prepared statement of Senator Robb appears in the appendix.]

The CHAIRMAN. I would now call on Mr. McCarthy.

STATEMENT OF JAMES T. McCARTHY, VICE PRESIDENT FOR TAX PRODUCT DEVELOPMENT, MERRILL LYNCH, PRINCETON, NJ

Mr. McCarthy. I thought I was just promoted.

The CHAIRMAN. You almost were. [Laughter.] Demoted, I should say.

Mr. McCarthy. Good morning, Mr. Chairman, other members of the committee. Mr. Moynihan, I would like to offer you a little relief, as a native New Yorker, a little respite from Delaware Day. On behalf of Merrill Lynch, I am very pleased and honored to be

On behalf of Merrill Lynch, I am very pleased and honored to be able to be here to testify. My principal responsibilities involve the architecture and marketing of tax-favored structures, both the IRA, the Roth IRA, the Educational Account, and co-chairing our involvement in the qualified State tuition plan arena.

I have made more remarks in my formal testimony which I have submitted for the record. Let me begin with my overall conclusions. People care tremendously about this need. My second conclusion, is the size of each challenge on the family level is almost always underestimated. The absence of a consensus about a clear path causes inaction.

Here is where Ms. Parker-Selby has dovetailed exactly with what I am going to say. While she would be more valuable in her current role, she has seized on the essence of the problem, the lack of a clear message, the lack of understanding of public education about the choices that are available, causes inaction, delays solutions, and exacerbates the problem.

My fourth point is, it will take time and a very simple message to change the behavior and people's thinking and start to attack this problem. For the last 10 years, we have built our franchise around planning, which fundamentally begins with profiling the

needs and capacities of our clients.

The number one goal is retirement. The number two goal is educational savings. Because it occurs so much earlier in the life cycle, educational savings is frequently the number one near-term priority. So, we are talking about the interplay between the dominant

goals that people need to save for.

As for the magnitude of the problem, as you yourself mentioned, Mr. Chairman, the cost of education and the amount of education needed to compete is constantly on the rise, where a college degree has replaced a high school education, as the entry-level criteria for many good and financially adequate careers requires the need to be both substantively strong and technology proficient continues to raise the bar in terms of the cost of education required.

The first two points are not news. We know that people care and we know that they have a hard time getting a handle on the size.

Where we think we can add value to the discussion is in our behavioral observations.

Educational savings today has no clear path, no clear, logical progression for the manner in which savings should occur. Each current choice has a neutralizing drawback. For example, the Education IRA, a very clear step and a very well-enunciated account is simply too small for the complexity that it brings to the table.

The UGMA and UTMA type of custodial savings accounts, there are some tax benefits, but there is an inability to really target those funds and they are turned over to an individual just at the point in their life where they may be least able to exercise sound judgment with regard to those funds. And, frankly, the amount of administration that is required to fill out those annual tax filings is not insignificant.

Unlike retirement savings which enjoys a well-tiered strategy of 401(k) or employer-sponsored type of plan provisions, funding an IRA, if there are additional savings to be done, there are tax-deferred vehicles like annuities, for example, but there is a well-worn path which people are aware of which is consistently trumpeted out

into the media, and people feel that they can step onto that path and follow the progression without making unwise choices.

The current perception that a parent's choice will be an unwise one or not the optimal choice causes inaction. This is where the melding of Education IRAs and qualified State tuition plans can create that path. We believe that enhancements can be made to both programs that, when dovetailed together, create that logical path.

If we solve that problem, as Ms. Parker-Selby pointed out, then the financial institutions, including the banks, the insurance companies, the securities firms, will band together and rally around in that kind of massive public education and advertising campaign that we saw for the Roth IRA in 1998. But it is that type of concerted effort that brings public education and awareness to people.

I have specific recommendations that are included in my testimony. Let me just run through them fairly quickly. I believe we need to increase the Education IRA limit to at least \$2,000, eliminate the income limits for the complexity that they lend without necessarily the value, change the contribution deadline to conform with other IRAs, and I also believe that we need to enhance State tuition plans.

There is excellent work done by the State treasurers, Mr. Graham, the college savings plan network group of the State Treasurers. But I would urge you to be careful not to diminish the pro-

gram.

An enhancement to the tax treatment of those structures should be done in recognition of the size and scope of the problem, not resulting in actual diminishment of the amounts that can be contributed to those plans.

That sums up my remarks. The balance of my testimony is in my

formal statement.

The CHAIRMAN. As I indicated, it will be included as if read.

Mr. McCarthy. Thank you.

[The prepared statement of Mr. McCarthy appears in the appendix.]

The CHAIRMAN. Now it is my pleasure to call on Ms. Garland.

STATEMENT OF ALEXIS GARLAND, PROCUREMENT COORDINATOR, HEWLETT PACKARD, NEW CASTLE, DE

Ms. GARLAND. Good morning, Mr. Chairman and members of the committee. My name is Alexis Garland. I live in New Castle, Delaware, and I am a procurement coordinator at Hewlett Packard in Wilmington.

HP is one of the world's largest computer companies and makes other products, including test and measurement, medical, and chemical analysis instruments. The company employs over 120,000

people and had revenue of \$47 billion.

Thank you for the opportunity to discuss the reasons my company and its employees would benefit from legislative action making Section 127 a permanent part of the Tax Code.

Today I am telling my story, but I am just one of over 5,000 HP employees who has taken advantage of Section 127 to better them-

selves. Therefore, I am here on behalf of all those employees.

I graduated from high school in 1970. I was one of five children, and college was not an expense my family could afford. So I started my career working two part-time jobs. Of course, having no benefits, I sought a better opportunity and was hired by ICI America as a file clerk. Unfortunately, 3 years later my division was sold and moved to Texas. I was unable to move, so I lost my job.

Staring unemployment in the face, I was lucky to land a secretarial position with a small rental company. It was then, after having taken a pay cut, that the importance of continuing my education became crystal clear. I knew that a degree would give me the edge I needed to advance. However, I could not afford the ex-

pense and assistance was not available.

Fortunately, I was hired as a clerk for DuPont. After the birth of my second child and a number of years in my job, I decided it was time to take advantage of the company's education assistance program and to make my dream of a degree a reality. So in 1985, at the age of 33, I began my studies.

Several years later, I found myself downsized out of DuPont. I was given outgoing educational assistance and, for the next year, I worked for a temporary agency and completed my associate de-

gree.

I was then able to secure a position at BT&D Technologies as a customer service representative. The company offered educational assistance, which I immediately used to continue college. Eight months later, BT&D was sold, and fortunately the buyer was Hewlett Packard. HP offered excellent educational assistance and a great opportunity for advancement, so I happily joined the company in 1993.

Three years later, I completed my bachelor's degree. As I walked onto the stage at Wilmington College, I thought about the 10 years I have spent attending classes, writing papers, and taking tests, all

in my spare time.

My son was 5 when I started my degree, and 16 when I graduated. I had worked full-time, raised my family, and earned a college diploma. Obtaining my degree was not easy, but it would not have happened without educational assistance and Section 127.

Yes, I missed precious time with my family, I gave up numerous social activities, and I drove a car with over 150,000 miles to my graduation. However, the benefit of building a better future for my family far outweighed the sacrifices.

Section 127 was in place during most of the years that I was in college. I understood that, as long as I stayed within the dollar limit, I would not have to pay tax on my educational assistance. However, when Section 127 lapsed, I viewed the possibility of being taxed on my assistance as a contradiction and a disincentive. Making Section 127 a permanent part of the Tax Code just makes sense, because everyone wins.

Last year. I was the successful candidate for a procurement coordinator position. The new job moves me one step closer to my cur-

rent goal of becoming a commodity manager.

However, in speaking to my supervisor, I recently learned that an MBA is desired for the job. The thought of pursuing a Master's

degree is exciting, but may not be realistic.

As a single mother with a college-aged son, finances are tight. The only way that I could even consider attending graduate school would be with the assurance of educational assistance that included tax exclusion. I don't think it would be easy for anyone to give me those assurances today. I know all too well that change is inevitable and that job survival is dependent upon continuously improved skills.

Educational assistance and Section 127 are tools that can help thousands of people just like me to succeed. Therefore, it is my hope that Congress will make the educational assistance tax exclusion a permanent part of the Federal Tax Code for graduate, as

well as undergraduate, level courses.

In closing, I want to thank Chairman Roth, Ranking Member Senator Moynihan, and the rest of the committee for your hard work. I will be happy to answer any questions that the committee may have at this time. Thank you.

The CHAIRMAN. Thank you, Ms. Garland.

[The prepared statement of Ms. Garland appears in the appendix.1

The CHAIRMAN. Now it is my pleasure to call on Ms. Hughes.

STATEMENT OF SHIRLEY HUGHES, SENIOR VICE PRESIDENT FOR HUMAN RESOURCES, CERIDIAN CORPORATION, BLOOM-INGTON, MN

Ms. HUGHES. Good morning, Chairman Roth, Senator Moynihan, members of the committee. I am Shirley Hughes, senior vice presi-

dent of Human Resources for Ceridian Corporation.

Ceridian is a leading information services company, providing services in the areas of human resources, research, as well as transportation. Today I am here testifying on behalf of the National Association of Manufacturers, and also the 127 Coalition.

First of all, I would like to thank Senator Moynihan and Senator Roth for introducing legislation to make permanent the Section 127 tax exclusion for employer-provided educational assistance and to extend 127 to cover graduate education.

The Senate Finance Committee has a history of support for Section 127, and we thank the committee for the support of these provisions last year. We certainly appreciate the opportunity to discuss the importance of Section 127, and the benefits to both employers and employees of reinstating graduate-level education and making this provision permanent.

Ceridian has a history of providing tax assistance policy that goes back at least 30 years. Certainly, tuition aid has changed people's lives. I would like to share with you just a couple of examples.

One is of a former secretary who started out in our corporate tax department, a single mother of two children. She returned to school, got her degree, and now she is a tax accountant in our corporate tax department, and is also looking at pursuing an advanced degree. She has been an employee for 20 years, and with very excellent service.

In one of our other businesses, Ceridian Employer Services, which is our human resources and payroll business, there is a man who started out in an entry-level technical service position. But he was able to complete a college degree with the help of tuition assistance, and today he is the district vice president of Client Services.

Our testimony today can be summarized in one simple sentence: making Section 127 permanent law and extending its coverage to graduate education is a triple win. First of all, it is a win for employees because they are permitted to exclude tuition assistance from their taxable income.

It is certainly a win for employers because it enables employees to acquire additional education and skills, and certainly to end up with more valuable assets. And it is a win for our country, for America, because it helps raise educational attainment, which is certainly a key driver of U.S. productivity and what is becoming very much of a knowledge economy.

Though first enacted 20 years ago, Section 127 is one of America's best investments in the future: 21st century skills for 21st century jobs. We urge the committee to approve the Moynihan-Roth

bill, and we certainly hope that Congress will enact it.

Mr. Chairman, despite the necessity of higher education and training, workers often lack access to educational opportunities. Many employees who are receiving aid are in entry-level, lower paying jobs. They cannot afford to pay for additional education.

As has been commented on earlier, the average age of the undergraduate student has very much increased. More than one-fourth of all undergraduates today are over 30 years old, and many of them are supporting families. Tuition assistance is often the only way people can afford to upgrade their education while continuing to work and support families.

At one of our businesses, Ceridian Employer Services, approximately 10 percent of their domestic work force currently receives tuition assistance, and some \$370,000 was provided to employees last year. Although most companies' tuition assistance policies do not provide 100 percent of the cost of education, it certainly helps.

The earlier stories of the district vice president for Client Services, or the corporate secretary who is now a tax accountant illustrate another benefit of Section 127. It allows employees to exclude from their taxable income tuition assistance they receive for education that may not be specifically job-related.

Section 127 allowed our tax secretary to pursue a degree that might not have been considered directly related to her job as a sec-

retary, but certainly enabled her to have a better career.

Lifelong learning does not stop with an undergraduate degree. To encourage employees to pursue educational opportunities, Ceridian provides tuition assistance for a broad range of degree programs, including graduate-level education. We believe that the education level an employee pursues should not be limited by the tax treatment of that education.

In closing, Mr. Chairman and members of the committee, I would return to the beginning of my statement and urge that Congress and the administration view Section 127 as an investment in 21st

century education and skills.

Congress needs to do everything possible to support the trend toward educational partnerships for lifelong learning. Section 127 is one critical piece among many public policy initiatives to promote education and training. It helps employees learn, it helps employers have a work force that is competitive, and as a country it helps us to be more competitive in a global economy. Thank you.

[The prepared statement of Ms. Hughes appears in the appen-

dix.]

The CHAIRMAN. Thank you, Ms. Hughes.

Let me play the devil's advocate for a moment. I look like it, too, I know. Of course, Pat Moynihan and myself are enthusiastic sup-

porters of making 127 permanent.

But one of the criticisms we come up against is, well, basically it is corporate welfare. If it is important for a company to have better educated employees, they should pay for it. How do we answer that?

Ms. HUGHES. Corporations, in addition to tuition assistance, spend lots and lots of money in terms of training to help people with new technologies, and training for current jobs. One example. One of our businesses, Ceridian Employer Services, that I referenced had spent \$370,000 in tuition aid, the same year, last year, they spent over \$5.2 million in training their employees. So I think employers are.

The CHAIRMAN. Are contributing. Ms. HUGHES. Yes, substantially.

Senator MOYNIHAN. Of course they are.

The CHAIRMAN. Ms. Garland, would you care to comment on that?

Ms. GARLAND. Could you repeat the question again?

The CHAIRMAN. On Section 127, making permanent the tax incentives for a business to provide undergraduate and graduate funding for employees, how do we avoid the charge that it is corporate welfare? Please proceed.

Ms. GARLAND. All right. I do not think it is corporate welfare. I think it is investing in their own company. Any time you can train your employees to do a better job, you are also investing in the em-

ployee's future.

It makes the company more competitive, it makes the employee more competitive for a job. When I am given a promotion because of my degree, I am paying more taxes, so it stimulates the country as well. It just makes is more competitive with other companies and other countries to have the education benefits.

The CHAIRMAN. I strongly agree with you.

Ms. Parker-Selby, let me ask you this. You made a very eloquent statement about how difficult it was to save money for education, not only for you, but for your children and your grandchildren. As you plan for the future, how will the newly-created education savings incentives fit into your decision; how will they help you?

Ms. Parker-Selby. Oh, they will help quite a bit. One way they will help, is because we can not worry about having to have a lot of money to even begin to save in this area. Like, with the Delaware plan, we can go as low as \$50. I will go a little bit more than that, but it is an incentive to know that you do not have to feel that you have to just have lots and lots of money to begin saving for college.

The ending of this savings will be worthwhile. Right now you are looking at being taxed, but hopefully we can convince you folks that we can go tax-free, and it gives us even more incentive to know that that money will be there for the education of the children and not have to worry about more taxes to be on that. I am getting

older and I will not be able to afford all of that.

The CHAIRMAN. Of course, it will be built up through compound interest, which is important.

Ms. Parker-Selby. Yes.

The CHAIRMAN. Let me ask you, as a principal of a school and as someone who interacts every day with parents, how knowledgeable are they about these programs and what can we do about it? What steps can we take to improve knowledge on the part of our citizens?

Ms. PARKER-SELBY. They are limited in the knowledge. They maybe hear something about it, but they are not quite as in detail about what it is all about. I mention it to people on my PTO, and I have a very active PTO.

Some of them were saying, oh, is that so? I was basically talking about what I would be coming here for. Everybody wants to know, well, what benefits will we get, and will you have to pay more

taxes.

Those were the key words that I kept hearing. I think one of the things that I have been involved in through the Higher Education Commission is to make sure we begin to talk about the plans that are available.

Now, they are offering opportunities for parents to have people to come in, consultants, and talk at meetings. That is one angle that I feel will be good. Also, a continuation of media advertisements and TV types of advertisements to let people know these opportunities are there, because right now people really do not know.

In fact, I have to admit, I am learning. If I were not on the commission or not as involved out there with the actual types of educational opportunities and programs, I would probably not know ei-

ther. Then I would be borrowing again.

The CHAIRMAN. Well, you make a very interesting suggestion. Mr. McCarthy talked about media, TV. But you suggest that more could be done through meetings.

Ms. PARKER-SELBY. Yes, I think so.

The CHAIRMAN. Is much done in this way?

Ms. PARKER-SELBY. Not yet. We are still fairly new with it. But there is conversation that this type of information should be done through meetings. I said PTO meetings, because that way I would reach my constituency as far as the parents being involved.

I also look at community groups, Kiwanas, Lions Clubs, and other groups of that nature, to go out and spread the word, because lots of grandparents are in a lot of those groups, retirees, and so

forth.

The CHAIRMAN. I think that is a very worthwhile suggestion, Pat, if we get parent-teacher groups, for example, to become more conscious of these incentives. The earlier they start savings, the better off we all are.

Ms. PARKER-SELBY. Correct.

The CHAIRMAN. Mr. McCarthy, if I understand your testimony about the importance of publicity and the importance of simplification of the programs, how would you simplify these programs so

they are better understood?

Mr. McCarthy. Let me begin, Mr. Chairman, by saying, at our firm alone, which we believe is fairly representative of the efforts marshalled by other firms, we did 2,700 public seminars about the Taxpayer Relief Act of 1997, ranging from 800 people in Detroit to sometimes as few as 15 or 20 in a public library, or one of our office conference rooms.

This type of education is critical to getting these messages across. An advertisement, all it can do is spark interest and deliver a very narrow, bulleted message. It is when you get people into a room and are willing to have a 45-minute to an hour and a half dialogue and discourse that you can really engage in some knowledge transfer.

To your specific question, there are a number of things about these programs, for example, the Education IRA that has a filing contribution deadline of December 31. The rest of the IRA world has an April 15 contribution deadline. Alignment of those rules tends to make sense because there are times of the year when peo-

ple think about these issues.

Almost half of our IRA contributions, for example, come in the first quarter of the trailing year, between January 1 and April 15 of the following year. It is when people assess their tax situation, assess the money coming back to them in the form of a refund, and so forth, that they are able to make these contribution decisions. You want to capture that momentum during that time of the year so you would align these rules together.

Quite frankly, with regard to any of these plans, the interaction, for example, between the Hope and Lifetime Learning Credit and the mutual exclusivity between the benefits of the Education IRA and that do not seem to make a lot of sense and scare people off.

It is those linkages.

I think people feel, quite frankly, that if they are not home watching C-SPAN 24 hours a day, that they are not going to comprehend the rules. Thus, whatever they do will not only be suboptimal and make them feel slightly foolish, they will get tripped up later with a form or a filing that they forgot to do.

The CHAIRMAN. Let me turn to you, Ms. Garland, if I may. First of all, let me commend you for persevering and receiving your college degree.

Ms. GARLAND. Thank you.

The CHAIRMAN. Let me ask you this. As a working mother, could you explain to us, what was the real-world effect of having a gap in applicable time period for the benefits of employer-provided educational assistance?

Ms. GARLAND. Well, for me it was the uncertainty of knowing whether I was going to be taxed on that money. As a single parent, I cannot afford to have that. I am not sure of the tax, but I know

it could be up as high as 45 percent, the bonus tax.

I cannot afford to have an additional 45 percent of my paycheck just disappear. You have rent, you have kids to take care of, you have bills. That uncertainty is very unnerving, to whether you are going to lose those additional funds or not.

The CHAIRMAN. Am I correct in understanding, as you look forward possibly to getting a Master's degree, the uncertainty as to whether there will be a tax advantage or not is a very negative fac-

tor in making up your mind what to do?

Ms. GARLAND. Yes. Because if graduate-level classes are not included in Section 127, I do not know of any way I could afford to go to college at this point in my life.

The CHAIRMAN. Well, we hope you keep proceeding.

Ms. GARLAND. Yes, I hope you do. The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I am just both moved and inspired by this testimony. In evidence whereof, I will try to be truthful in some of the things I say, even if they are painful, about the importance of the Section 127 measures which you and I are offering, and which you have been so kind to comment on.

The first thing, is to say that education policy is difficult to follow in the United States right now. We pay almost no attention to what we have learned by way of research. Most of the important research on the subject was done in the 1960s. I was involved in

some of it, and so assert.

I will tell you, there is no heed whatever in the public pronouncements you will hear in Washington, or most State capitals, and right now at very high pitch. We have 40 years of careful studies of the effect of class size on school achievement, and they invariably find there is none. Yet, we know that smaller classes produce better students. They also produce happier teachers, which is all

right by me. But do not say the other.

In 1990, under our revered former President, George Bush, a meeting down in Williamsburg occasioned with the Governors, the first time this sort of thing happened, we set out on the goals for the year 2000. We said that American students would be first in science and math by the year 2000 in the world tests. There are several eighth grade tests which are the best. Of course, everybody is in school by the eighth grade, the 12th grade a little less so, because not everyone in every country is in.

Well, if you said the equivalent of "the United States is going to be first in math and science for its eighth grade students for the year 2000," in some other setting at a slightly earlier stage, you

might have been taken away as delusional, and possibly dangerous to your associates. I mean, delusional. Then we formally enacted

the laws in 1994, I believe, the National Education Goals.

The latest returns—there will be a new one this spring—are in the Third Annual Math and Science Study, in which U.S. eighth graders ranked 28 of 41 countries in math, and 17 in science. Yet,

we are still talking about being first, what, next year? In 304 days?

Now, there is a disconnect. There is a leakage of reality here. There is nothing you can do about it. It is too late in my life. I have

tried for 30 years and have had no success of any kind.

But one thing we do know, is that Americans grow up on their own, despite the school systems, and as adults begin to think, "I could know more and could learn more."That is what employee education assistance does.

It has an extraordinary grasp on reality. Here is someone an employer is prepared to pay money to send to school to get a higher level of training and education, get a higher job and pay more taxes, make us happy, and so forth, and so on.

We started this in 1978. I was here. But we cannot make it permanent. What is the matter with us? I mean, are we lost to reality? I am not haranguing you, citizens. I love you. But now we have a proposal to add graduate school.

I think, Ms. Hughes, there are probably about a million recipients right now. We would probably get another quarter million in the graduate area. We know it has returns, and we do not do it.

We keep putting it off, putting it off.

Does anybody have an explanation for this? If you say you do, you do not. Do not say you do. But thank you for what you are doing. Thank you for your testimony. We had better watch out.

What do you think the future of a country that is 28 of 41 in

math and 17 in science will be? Who is going to be here 30 years from now at the top of these lists, whilst we are still saying we are going to have goals for the year 2040? As I say, it is delusional. I do not know any cure for it, but I do know we had better pass this bill this year, sir.

The CHAIRMAN. I could not agree more strongly with you, Sen-

ator Moynihan.

Next on the list is Senator Graham.

Senator Graham. Thank you, Mr. Chairman. I would like to ask a couple of questions. Several have commented about the desirability of extending these various Federal programs intended to encourage continued education to the graduate level.

I had a chance conversation on Monday with a very prominent

Floridian by the name of Henry Smith, former president of the American Bar Association, who is now teaching at a Florida law

school.

He was saying that he was struck with the fact that so many of the current generation of law students were interested in doing something in the public service area but were restricted from doing so because they had so much debt by the time they graduated that they did not have any option but to try to take the best paying job they could get, regardless of what their preferences might have been. That is just one implication to our society of the high cost of graduate education.

I would like your thoughts as to what might be done, either through expanding some of the existing programs such as the employer-based funding to graduate and professional education, or making some of the existing prepaid type programs available for graduate education.

Senator MOYNIHAN. Could I say to my friend that the bill we

have before us now extends to graduate education?

Senator GRAHAM. Well, I am pleased to hear that. I would like your comments as to, what are some of the policy or technical issues that we might need to think about if it is our desire to expand existing programs to the graduate and professional level.

Mr. McCarthy. As a policy matter, the slate of opportunities that are available right now, be they the Education IRA—well, the Education IRA, for example, has a requirement that the account has to be emptied out by the age of 30. As Ms. Hughes said, a quarter of our undergraduate students today are over 30.

The competing priorities and the complexities of personal life have become such that educational patterns continue to get extended outwards. As a result, you are going to be hitting graduate

school much later.

Graduate schools, in fact, want you to come back to them after some real-world work experience so that your learning is leveraged by the fact that you have had your feet wet in the private or public sector.

So, as a result, for example, that, as a policy matter, does not seem to make a lot of sense to me, that you create an educational vehicle and then it has got to be emptied out, in effect with a penalty, by the age of 30. So uncapping that, I think, makes a lot of sense.

With regard to the State-sponsored tuition plans under Internal Revenue Code Section 529, those plans right now are generally, under the full construct of the law, available for graduate education. They, because of the higher contribution limits, hold out the

most hope of providing a solution.

Quite frankly, I talked a little bit about people underestimating the cost of education. As you know, the need to become not only proficient in math or science, as Senator Moynihan has said, but to be technology proficient to correspond via the Internet and do computer-based research and so forth, means that the cost of education, just on an undergraduate level, is going up, and graduate,

exponentially so because of the level of sophistication.

State-sponsored tuition plans actually hold out the greatest hope in that area. I would urge the committee, and I know that you have taken a leadership role in bringing us to the point where we are now, is while some people perceive the contribution limits as being very high, in reality they are not, especially when you factor in the kind of lifetime educational need, or the cost of providing for multiple educations within a family. I mean, I applaud the other panelists for keeping their priorities fixed and solid and getting educational resources out of relatively meager means. But, in reality, large families have this problem multiplied.

Just saving for three children, in present value terms, equals two-thirds of the cost of saving for retirement. So people are left with these either/or choices. They either deplete their retirement or they leave their children with what can be a very crushing debt burden.

So I would urge that, in answer to a suggestion, if there is discussion about increasing the tax benefits of qualified State tuition plans, I think the overall size of the contribution limits should not be the first casualty.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman. I have got a couple of questions, but before I get to the questions I would like to tell my colleagues about some education tax incentives that I have put in so they can consider them for co-sponsoring, and other

things.

First of all, Mr. Chairman, to say thank you to you for focusing this committee's work today on this very important issue of education and how the Tax Code can be used to help education, because wherever you go, or any polls you take, education is at the highest level of concern of our constituents, I think, in almost every State.

Last week, Senator Baucus and I introduced my bill to remove the 60-month payment limitation on student loans, thus through

that bill expanding the interest deduction on student loans.

When I started that effort back in 1987 to restore the deduction, there was not any limitation at that time. But we had revenue problems when I finally got the bill passed 2 years ago, so we had to place some limitations on that deduction at 60 months.

Now that we are in a better position to return money back to the taxpayers, one of the best and fairest ways I think is to provide

more and extended educational benefits.

Then Senator Graham, a colleague of ours on this committee, has already mentioned, I have joined him in introducing a school construction initiative. Our bill would expand the current and very successful use of tax-exempt bonds. Tax-exempt bonds are the single most important source of financing for State and local investment in public school infrastructure.

Tax-exempt bonds are efficient, they are popular with investors, and well understood. Because the Federal Government forgoes the tax revenue on interest earned by investors, the investors then demand a much lower rate of interest and States and localities bene-

fit from that lower cost of capital.

Tax-exempt bonds are a better investment, provide greater and more flexible assistance to the States, and result in more schools being built and repaired. In my State of Iowa alone, we had \$600 million of school construction bonds issued just last year, and we

are a State of only three million people.

In the fiscal year 2000 budget, President Clinton has proposed policy initiatives that would enhance and expand the use of the Qualified Zone Academy Bonds. That is called QZAB, for short. Despite this proposal's praiseworthy goals, its problems are pretty deep-rooted. I think that any attempts to tinker with it or expand the program are doomed from the start.

As a matter of fact, I believe only two issues of these bonds have taken place. This underscores the fact that the program is not working, and I hope that we can get something that Senator Graham and I are proposing and get the administration to wake

up that their program is not working.

Next week, I am going to introduce the Omnibus Tax Relief bill that will fix many of the problems that exist in taking advantage of the Hope scholarship program and other educational tax benefits.

I think, Mr. Chairman, we have a unique opportunity to provide a broad range of educational tax relief to the American people, but we are going to have to keep our priorities straight in order to ac-

complish it.

So I hope all members will join me in setting these kinds of issues as our top priority as opposed to what some other people are proposing, having some sort of an across-the-board proposal that will end up eating up all the revenue and then prevent us then from doing some of these targeted tax relief issues that the public

at large really want.

My first question would be to any of you: how do you respond to the argument that tax benefits intended to reduce educational costs actually give colleges and universities incentives to raise their tuition because they know people will be able to afford the higher costs of college? You do not necessarily have to agree that that actually happens, but that is an accusation that is made. And any or

all of you responding to that, I would appreciate.

Ms. HUGHES. One response I would give, Senator, is that if you look at the tuition assistance that is provided to people, it does not nearly cover 100 percent at all, what is being provided through employers. In fact, it does not matter. We looked at some State schools in Minnesota, some other places, and in no way is it covering 100 percent. So that could not be some kind of incentive for schools to raise the fees.

Senator GRASSLEY. You are aware of the accusation though, sure-

ly.

Ms. HUGHES. Yes.

Senator GRASSLEY. Anybody else?

Mr. McCarthy. My feeling on that subject is the following. While we do not have a lot of embedded learning from the Hope and Lifetime Learning Credits, because they are relatively recent creations—that was a brief statement.

Senator GRASSLEY. No. The Chairman always lets you finish

your answer.

Mr. McCarthy. Thank you. There are a couple of facts that I think are indisputable. College tuition inflation remains a multiple of general inflation in the environment. So we know, while college tuition inflation has abated slightly from the higher levels of the early 1990s and the late 1980s, we know that it is still two to three times what inflation is in the general population.

Senator GRASSLEY. Yes.

Mr. McCarthy. Tuition tax credits, which apply to a broader base, dissolve some of the free market tension between the student and the college. As the provider of the service, the college is relatively sure that one of two things is going to come to their door, somebody who is either able to pay their own way, or they have got a tuition tax credit available to them from the Federal Government.

As a result, while I cannot say with any proof that inflation results from that, certainly the desire to minimize and be more com-

petitive is somewhat dampened.

Other programs, the Éducation IRA, saving through qualified State tuition plans, which are behaviorally based, put the incentive and the power, the consumer purchasing power, in the hands of the parent or the student coming to the school, so they mask necessarily to the school at first what is available to be paid and, as a result, encourage the school to be more competitive. Quite frankly, they are out there competing for qualified students with not only the other public institutions, but the private institutions as well.

So behavioral rewards for savings—I mean, we know in this country we have too low a savings rate as it is. I would submit to you that that is a better way to go.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman. Thank you very much for holding this hearing. I think we are talking about some of the most important issues facing our country and facing my State, certainly.

I was raised in a family, raised by my grandparents. Education was number one, number two, number three on the priority list. The clear emphasis was, if you want to make the most of your God-

given talents, the way to do it is through education.

So I very much hope that we will pursue the issue that is before us today with respect to tuition paid plans by employers, so that those who are the recipients of that assistance do not wind up paying taxes on that amount, that we extend it to graduate students.

I think more and more, without a graduate degree, people are not going to be competitive in this world economy. So it is critically important that we prepare them and we make an investment in

their preparation.

I spoke last night to the Senate Youth Caucus, the program sponsored by the Hearst Foundation. I talked to 104 young people from all across the country, really the best and brightest who come here every year under a program sponsored by the Hearst Foundation. You could feel the energy and the dynamism in that room, and you could feel good about the future of America.

Two youngsters sitting on either side of me from North Dakota told me their big challenge is paying for a college education. That is a big challenge for them. So I hope we pay close attention to

what we are being told.

I have got two children in private schools and college right now. I can tell you, it reminds me a little of what they used to say about George Washington. He had an unlimited expense account, and he exceeded it. Sometimes I feel that way about what the costs of higher education have become in this country. It really is astounding.

I also turn my attention to I think what will be addressed in the next panel, Mr. Chairman, which is the question of school construction. I wanted to make special mention of the challenges that we have there, especially in Indian country. In our State, we have a

number of Indian tribes who have truly deplorable situations in their schools.

I was at one just recently, and the school was designed by an architect somewhere in the southwestern part of the United States. They clearly had no idea of what a North Dakota winter is like because the heating system was inadequate. It was built on this open classroom format, which is a disaster. If you are in a school with a bunch of highly energetic young people and there are no walls separating the classes? You cannot hear yourself think.

The heating system on one side of the school is 55 degrees, and on the other side it is 75 degrees. It is an impossible situation. It is going to cost \$2 million to fix it. There is no money to fix it.

The President has proposed a bonding program that would allow \$25 billion, \$400 million reserved for Indian school construction across the country. We have got a backlog. We just heard a report in the Indian Affairs Committee earlier this week. A \$1 billion backlog. Schools that need to be fixed. And I am not talking about minor fixes, I am talking about truly deplorable conditions.

So I hope that we will pay attention to that issue as well in this committee, Mr. Chairman. It is absolutely essential that we give the tools for school construction and school repair to those across the country who want to make certain that their kids have a good

educational opportunity.

I would just like to ask the panelists here, if you could sum up in two sentences the message that you would want to transmit to people across the country with respect to this issue, what would it be? If you had to boil it down—the reason I ask you that, is because that is what we have to do. If you want to get a message across, it has got to be simple and direct. What would your two-sentence message be? Ms. Hughes?

Ms. HUGHES. Educational assistance is absolutely vital for our people, the American work force, to be able to be competitive now

and into the future.

Senator CONRAD. All right. Very good.

Ms. Garland?

Senator MOYNIHAN. You can get a job with any committee in town here. [Laughter.]

Ms. GARLAND. I would say, just to stay competitive within com-

panies, with each company, and throughout the world.

Senator CONRAD. All right. Thank you.

Mr. McCarthy?

Mr. McCarthy. I would urge every parent and grandparent to take an hour to go to a public library and learn about the variety of programs that are available. Informed choices are going to be the key to making intelligent decisions and solving the problem.

Ms. PARKER-SELBY. I am saved by the bell.

Senator CONRAD. No, no, no.

Ms. Parker-Selby. Basically, I would say we need to concern ourselves with all children of all backgrounds and levels in this country and make sure that, in order to keep this country the strong country that our forefathers died for, that we do all in our power to give them every opportunity possible financially, psychologically, emotionally, what have you, to get them educated and let

them know that they are worth something, and they will keep our country strong.

Senator CONRAD. That is wonderful. Excellent answers. Thank

you very much.

The CHAIRMAN. Thank you. And let me thank each and every one of you for being here. Your testimony has been most helpful. I think we all agree as to the importance of education. Education for all of our children has to be our goal.

Thank you very much. We look forward to talking further with

you.

Mr. McCarthy. Thank you, Mr. Chairman.

Ms. PARKER-SELBY. Thank you.

Ms. GARLAND. Thank you. Ms. GARLAND. Thank you.

The CHAIRMAN. Well, our last panel consists of three witnesses. These witnesses should help us begin to understand the various issues involved in school construction. I would ask all three wit-

nesses to please come forward.

Our first witness is Dr. Dennis Zimmerman, a specialist in public finance at the Congressional Research Service. Dr. Zimmerman will provide us with an economic and historical perspective on the policy of increasing Federal financial support for what has historically been a State and local responsibility.

The next two witnesses have both had hands-on experience at the local level. Bill Manning has been president of the Red Clay Consolidated School Board in Wilmington, Delaware for the past 10

years. It is great to have you here, Bill.

And Octavio Visiedo is currently an educational consultant, working on public/private partnerships for schools. Until 1996, he was superintendent of the Dade County Public Schools in Miami, Florida.

So we will hear from the witnesses, now. We will start with you,

Dr. Zimmerman.

STATEMENT OF DENNIS ZIMMERMAN, PH.D., SPECIALIST IN PUBLIC FINANCE, CONGRESSIONAL RESEARCH SERVICE, WASHINGTON, DC

Dr. ZIMMERMAN. Thank you for the opportunity to appear before the committee. I would like to submit my written statement for the hearing record.

The CHAIRMAN. All statements will be included as if read.

[The prepared statement of Dr. Zimmerman appears in the ap-

pendix.

Dr. ZIMMERMAN. The Federal Government, historically, has played a minor role in financing public elementary and secondary education. Most of its support appears as direct Federal spending

targeted to the disadvantaged and disabled.

The Federal Government also provides a relatively small amount of indirect assistance through tax-exempt bonds. This support is not targeted and reflects no Federal education policy objective. Its adoption was attributable to a desire to avoid having different levels of government tax each other.

Studies have suggested that more than \$100 billion of investment is necessary to restore school facilities to good overall condi-

tion. In an economic context, budget constraints are a fact of life. Our desire for both private and public consumption exceeds our ability to pay for it. An assessment of the condition of State and local capital facilities for any function, sewage treatment plants, prisons, et cetera, likely would reach a similar conclusion.

Decision makers must assess which activity will provide the highest value for marginal tax dollars. Perhaps local officials chose the existing less than good condition of education facilities because they placed a higher value on spending for other State and local

services, or on tax cuts.

In fact, data on passage of school bond referenda and a comparison of real growth rates for bond volume, State- and local-owned financed revenue, and school-age population suggests State and local school facilities have fared well by receiving an increasing share of State and local resources over and above what would be necessary to accommodate increases in school population.

Of course, these data are averages and might hide a subset of communities that find it difficult to maintain adequate school facilities due to concentration of the poor, concentrations of retirees, high population growth rates, and tight State/local borrowing re-

strictions and/or super-majority voting requirements.

Four bond proposals have suggested ways to increase Federal financial assistance for school construction: the administration's school modernization bonds, the extension of the spend-down period for arbitrage earnings, the increase of the small-issuer volume ceiling for exemption from arbitrage rebate, and the use of private activity bonds for education facilities.

Due to time constraints, I will not describe each proposal but will discuss their effects on the share of debt service costs borne by Federal taxpayers and compare their targeting to the education policy objective expressed by the targeting of Federal direct expenditures.

Cost reduction. First, all of these proposals are designed to lower the cost of investing in school facilities relative to investing in capital facilities for other public purposes, a powerful incentive to alter State and local spending priorities, a role not generally played by tax-exempt bonds. Tax credit bonds pay 100 percent of State/local interest costs, compared to about 25 percent for traditional tax-exempt bonds.

The two arbitrage proposals, assuming a 0.75 percent arbitrage profit is earned, would increase earnings from one percent of the amount borrowed to about 2.5 percent of the amount borrowed. If combined with tax credit bonds, the percentage would rise from about 2.5 percent to about 20 percent. Most jurisdictions, remembering Orange County's experience, will be cautious in this regard.

Using private activity bonds might reduce the Federal share of State/local interest costs. Why use them? First, private activity bonds require the issuing jurisdiction to hold a public meeting, but

they do not require a vote.

Second, the corporation might be a more efficient builder and operator of the facility and might provide lease terms that cost less

than principal and interest payments on the debt.

Targeting. Half of school modernization bonds would target districts targeted by the Federal Government's existing Federal education spending programs. The other half, potentially, could target

other school districts.

The spend-down arbitrage proposal applies to all school districts, the other proposal targets small districts. In either case, much of the assistance would go to districts not currently targeted. Finally, the private activity bond proposal targets high-enrollment school districts. Much of the assistance would go to districts not currently targeted.

That concludes my testimony. Thank you for the opportunity to

discuss these economic aspects of the issue.

The CHAIRMAN. Well, thank you, Dr. Zimmerman.

[The prepared statement of Dr. Zimmerman appears in the appendix.]

The CHAIRMAN. Now we will call on Mr. Manning.

STATEMENT OF WILLIAM E. MANNING, PRESIDENT OF RED CLAY CONSOLIDATED SCHOOL BOARD, WILMINGTON, DE

Mr. Manning. Thank you, Mr. Chairman, Senators. I appreciate the invitation to appear here this morning. I have submitted writ-

ten testimony, and I will not read it.

My name is Bill Manning. I am a lawyer by trade. My passion is making public education work, so for the last 11 years I have been a member of the Board of Education for Delaware's second-largest school district, and for the past 9 years I have been president of that board. I have been active at the State level, promoting a variety of education reforms, school choice and school charter being among them.

My district is, one could say, a cross-section of Delaware, a cross-section of America. Some Red Clay citizens are affluent, too many Red Clay citizens are poor. The district stretches from the center of Wilmington out to the Pennsylvania border, and includes, therefore, a variety of different kinds of neighborhoods, both urban and

suburban.

We have a large component of our population that is minority, including large African American and Hispanic populations, so we

look very much like the rest of America.

We have the same difficulties with our capital program that many other schools districts, I believe, are experiencing. Our newest buildings were built for baby boomers like me, so they are now 40 years old, at least. Those are our newest buildings. They are all leaking. We have not set about to repair those buildings because we have not had a capital program for many years in Red Clay.

In addition, we are a bit hoist on our own petard. As Red Clay has begun to renew public confidence and public education, and we have got a long way to go but we have started down that road, we find kids coming back to the system. So we are growing once again, for the first time in several years, and we need new schools in addi-

tion to the need to repair the ones we already have.

We, like many other school districts, have gone out for referenda. The first one failed. We were successful in passing a much less ambitious program. So we are settling in Red Clay. We are patching roofs and we are doing things that have to be done, but we are not nearly doing enough.

While Red Clay is very typical demographic...lly, it is, I would like to think, not typical programmatically. Red Clay was the first district, and the only district in the State of Delaware, to charter a school.

By the way, that school is doing very well. The headlines a couple of months ago announced that that charter school now has the highest SAT scores of any public school in the State of Delaware. We were the first school district to have district-wide choice.

More recently, we have come to an agreement with our teachers, the first time in the State of Delaware this has happened, by which our teachers agree to be judged based on the performance of their children

children.

So we are committed to improving education in Red Clay, and we are committed particularly to closing the gap between minority and non-minority academic performance.

As you ponder the role that the Federal Government ought to play in all of this, I would like you to include among your options

the diminution of that role rather than increasing it.

I say that for two reasons, one of which probably will not interest you. I happen to be one of those folks who thinks that if there is loose change rattling around in the Federal coffers, it should be

sent back to those who gave it to you.

More importantly, for today's purposes, I believe that one of the most important things we need to accomplish in public education is increasing accountability. It is now too easy to explain the failure of the public education system by having those involved in it point the finger at various different levels of government. As the locus of decision making shifts from the schoolhouse to the district office, to the State House, and now to the Federal Government, it is simply too easy to hide.

My main message today is that those who are responsible for improving public education need to be held at risk of the consequences for failing to do their job. With various different levels of government getting more and more involved, including the Federal Government, that accountability is becoming more and more

diffused.

If you choose not to diminish the role that the Federal Government plays in education, I would like you to at least consider adopting as guidelines the provision of neutral resources, not policy-laden, to be deployed at the discretion of local officials like me, those of us who need to constantly be exposed to the risk that we

fail to do our jobs.

I have reviewed a variety of the proposals that will come before you regarding school construction and my concern about over-regulation grows a bit. For example, I see an initiative as part of the administration's program only to provide construction assistance to those schools that would not have been built without such assistance. In other words, not to supplement or subsidize that effort that is going on right now. And you have heard Dr. Zimmerman testify to the quantity of that effort.

Well, my own view is that you should not penalize districts that have already bitten the bullet and are now engaged in a capital construction program. There is nothing wrong with providing as-

sistance to them.

I have a few specific thoughts that I want to leave you with. First, one of my passions is charter schools. Charter schools are an

interesting animal. They are not part of the regular system.

The regular system often regards those who promote charter schools as the enemy. So, to the extent there are school buildings lying around in America unused or under-used, one would think that those school buildings ought to go to charter schools, but they are not.

So, when you ponder the role that you might play in promoting bricks and mortar improvement in public education in America, please pay special attention to charter schools in America. I think they are one of public education's best hopes for the future.

My second specific comment is that I would hope that the committee would look for revenue-neutral ways to assist local governments in financing school construction, particularly where those

ways can decrease rather than increase Federal regulation.

And my favorite example of this is a little-discussed provision in the Internal Revenue Code, Section 149. It essentially says that tax-exempt bonds cannot be guaranteed by Federal instrumental-

Then it lists several exceptions, and those exceptions include Fannie Mae, Freddie Mac, and Sallie Mae, and the FHA, and the VA. But for some reason they do not include the Federal Home Loan Bank.

Now, the Federal Home Loan Bank is very interesting because it is a AAA-rated institution. If it could be in the business of enhancing credit for those who are selling bonds in order to build

schools across America, it could be of real assistance.

Yet, for reasons that no one seems to be quite clear about, that Federal instrumentality is not permitted to be in the market of selling credit enhancement products. A change in Section 149 is important enough for our State's Governor to have written to this

committee a few years ago about that very change.

I would leave you, if you are looking for specific suggestions about how the Federal Government, in a revenue-neutral way, can assist, it is by permitting a Federal instrumentality which happens to be a AAA-rated institution to sell its credit enhancement products out there in the market as school districts and other municipalities sell public tax-exempt debt.

Senators, thank you very much.

The CHAIRMAN. I would just say on that last point, the Senate did enact legislation, but it got lost in conference. We will try again.

Mr. MANNING. Well, I would only hope that it does not get lost

The CHAIRMAN. Thank you, Bill.

[The prepared statement of Mr. Manning appears in the appen-

The CHAIRMAN. Mr. Visiedo?

STATEMENT OF OCTAVIO J. VISIEDO, EDUCATIONAL CON-SULTANT, OV EDUCATIONAL CONCEPTS, FORMER SUPER-INTENDENT OF DADE COUNTY PUBLIC SCHOOLS, MIAMI, FL

Mr. VISIEDO. Thank you, Mr. Chairman, members of the committee. I would like to begin also by thanking you for giving me the opportunity to share some of my experiences, first, as a superintendent of schools of the fourth-largest school district in the Nation.

Just so that you have a sense of the size of the district, at the time I was superintendent we had 342,000 students, K-12 students, and over 250,000 adult education students, with a budget that exceeded \$3.8 billion.

Now, in my current role as a local, private educational entrepreneur, I guess, I remain a strong supporter of public education, quite frankly, because everything that I have achieved is thanks to public education.

My history with Dade County Public Schools began in 1961, when I arrived in the United States as an immigrant from Cuba, where I attended Citrus Grove Elementary as a fifth grader. It culminated with my selection as superintendent at the age of 39.

In large part, I was selected to the superintendency because of my success in dealing with the capital construction program that I alluded to earlier as deputy superintendent.

At that time, that program was the largest capital construction program in the history of American education. However, the depth and breadth of the problems that plagued our construction efforts were as substantial as the size of our program.

In Dade County, like many large urban districts, growth is fueled by immigration. That creates an additional pressure on school districts because these children need additional support in order to achieve academic excellence.

During my tenure, it was not uncommon for us to receive anywhere from 10,000 to 12,000 new students to our school district every single year, and most of those students had tremendous needs. We had to teach them, first, how to speak English, and also how to learn in their own language.

Additionally, these students brought with them a pattern of inschool district migration that placed incredible pressure on the school districts. Most of them would initially reside on the eastern portion of the county, then as their parents would progress, would start moving westward, creating incredible migratory patterns for the district to adjust to, which also affected their learning patterns.

Meanwhile, our school system was trying to deal with this construction program, trying to deal with the growth in a terribly complex environment that was full of regulatory obstacles. Early in my administration, I attempted to deal with those. Each of these regulatory obstacles created tremendous cost, time, and prevented efficiencies.

Just to give you one example of that, early in my administration I made a proposal to change the way design professionals and contractors were selected. The school board policy, in fact, gave additional preference to inexperience and limited the use of a prototype of a new facility to only three uses.

This policy was absolutely creating some major obstacles for us to overcome. The message there being, there are a lot of internal regulatory policies that have changed that could assist us in implementing capital construction programs in a much more efficient

pattern.

Another issue that had an impact was the issue of site selection. If you go to large, urban districts where there is not a lot of acreage, as it is in the case of Dade and Broward Counties, and you have a requirement to build a high school that requires 45 acres, it is almost impossible for us to locate those parcels and put them together. So that was another regulatory obstacle that, if overcome, could have allowed us to be more creative and have a different design in order to achieve.

What I would like to share with you is just two more points which are very critical, and it is all detailed in my testimony. We need to look for private/public partnerships. We have created one in my new role today in Pembroke Pines, which is the first munici-

pally owned charter school.

We have been able to, through a public and private partnership, create a workable, cost-efficient—which has cost us substantially less to build that building and manage it, and, as a charter school, utilizing the legislation that is available in the State of Florida, and, in fact, we have achieved that. We are paying for debt service and the operation of that facility for 95 percent of the operational

dollars that we get from the State.

Finally, as I see my time running out, I would like to encourage the committee, having heard some of the testimony, to keep a cafeteria of options available to you. I think school districts like Dade County, where you have such a variety of needs, I think some of the proposals that are talking about some of the public/private financing options are going to be of tremendous value to school districts that have a whole variety of need. Like Mr. Manning said, we need to give school districts the options to utilize those if, in fact, the need exists.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Visiedo appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Visiedo.

Let me turn, first, to you, Dr. Zimmerman. A lot has been made of a GAO report from a few years ago that declared a need for over \$110 billion of investment in schools. Now, accepting the fact that there is some gap between perfect condition and current situation, what does that number really tell us, in your judgment? Should we be focusing on it?

Dr. ZIMMERMAN. Well, it certainly is a problem. The question is, what is the magnitude of that problem compared to the problems we have in the other many public services that State and local governments are going to provide? As I said in my oral statement, if we did this for virtually any function they were responsible for—

Senator MOYNIHAN. What you would call opportunity costs.

Dr. ZIMMERMAN. Right. We would find gaps in prisons, in roads, in highways, hospitals, et cetera. The question really is, somebody has to make the decision, given that you have a budget constraint, limited tax dollars, where do we think we get the most value from these things?

It is not at all clear to me that the State and local decision makers have necessarily been irrational in making those choices, that they may have explicitly chosen, after due consideration, this level of condition of schools as the optimal, for want of a better word.

In fact, the data that are available seem to suggest that schools have fared quite well. If you looked at the approval rates for bond referenda for public schools, they were about 66 percent in 1988.

By 1991, they had fallen to 50 percent. But they have risen steadily since then and, in 1998, they were up to 67 percent approval, above what they were back in 1988 at the beginning of this time.

If you go back and look at the real annual growth rate for the last two decades of school bond volume, you find that it grew at almost an eight percent real annual rate. If you look at what the comparable rate is for State/local own-source revenue, you find it grew at about half that rate, at four percent.

That suggests that, in fact, schools are getting an increasing share of the revenues available to the State and local governments

and taxpayers.

You might argue, well, that reflects growing school population. But, in fact, over that period of time the growth rate in the schoolaged population was a mere two-tenths of 1 percent. So, I think it is a difficult thing to accept, going out and saying, how much do we need relative to some perfect standard.

I think of it as, I bought my house in 1976, and I am sure if somebody came by today and said, we want to evaluate the capital condition of your house, based on today's standards they would probably tell me that it requires about \$50,000 worth of work.

Well, it just so happens, my wife and I are going to put \$10,000 in this spring, but we are not going to put the other \$40,000 in because we think we value the use of that money on other functions, other activities, more.

I think that is perfectly analogous to the situation you see with respect to school finance. The data that you see do not suggest that

schools have been being treated badly, on the average.

The CHAIRMAN. Let me turn to you, Mr. Manning, on that point. Now, you testified that in your school district, of which you are president, that a school bond referendum was not agreed to initially. Then, later, it did pass, but it was less generous. Does that put you in conflict with what Dr. Zimmerman said?

Mr. Manning. Senator, no. While the experience in Red Clay may be atypical according to the data that Dr. Zimmerman has brought to this committee, I come, nevertheless, to the same con-

clusion.

So what I am saying is, even if Red Clay is atypical in that we did have difficulty passing referenda and we did not pass a referendum that permits new growth, I would still not ask the Federal Government to bail us out. I think that it is very important that communities are faced with the consequences of their schools not being good enough.

If there are Federal programs running the growth of school systems, it is simply too easy to blame the Federal Government and this regulation or that guideline for having inadequate schools. Local communities ought to belly up to the bar and be faced with

the consequences of inadequate schools without the prospect of the Federal Government coming to the rescue.

The CHAIRMAN. Let me ask you, Mr. Visiedo, do you have any

comment?

Mr. VISIEDO. I think my perspective is a little bit different. I also concur that I do not believe that schools have fared as poorly as far as construction is concerned. If you looked at Dade County, you would have looked at the kind of money that we had for our capital program and you would have said it is substantive. I think the only thing that that data does not reflect, however, is the pace of growth.

Just to illustrate that point, when we did our bond referendum, which was passed, we went school by school and analyzed the needs for renovations and additions, and we projected into the future, including some of the immigrant projections that we had.

The problem was that, during the late 1980's, early 1990's, when the political situation in Nicaragua became so strained, we were

getting 100 new students every single day.

Areas that had been previously projected to have a modest growth all of a sudden became explosive, and a renovation that was planned for that school no longer became a feasible alternative. So plans such as the one that you're suggesting where we can go, and, in fact, we had bitten the bullet. We had gone out and gotten our own referendum.

But where these unforeseen conditions came up and we had the ability to go and get some low-cost financing to help us on additions, because every one of those dollars that had been accounted for over a 5-year period as part of the bond referendum, that was a sealed bond with the community, that would have given us the option to address. So I do not necessarily disagree with the conclusions. I just think that certain school districts face unforeseen crises that have to be addressed, and options at our disposal would be very important.

The CHAIRMAN. Let me ask you this, Bill. How important is financing? In other words, in deciding whether to go ahead or not,

is the rate of interest a key factor?

Mr. Manning. I am going to give you two answers. School board members, when debating whether to go out for a referendum, will probably not be more incented to do that if there is a prospective of lower interest rates because of some Federal program.

However, once that decision is made, the decisions that you all make can be of great assistance in keeping the cost of that capital project to a minimum. You have a variety of ideas in front of you now, some of which include no interest loans and essentially to school districts because of the tax credit idea.

The Section 149 suggestion that I made a few minutes ago could reduce the costs of publicly sold debt. So, you have an important role to play in keeping the cost of that capital program down, but, in candor, I cannot tell you that a school board member would say yes to the prospect of building a new building, or no, depending on what the interest rates were that day and what programs were in place to reduce them.

The CHAIRMAN. Let me go back to your comments on accountability. According to the Treasury's green book on the President's budg-

et, for a school district to be eligible for the proposed tax credit bonds, the district "must demonstrate that a comprehensive survey has been undertaken of the construction and renovation needs in the jurisdiction," and, two, "describe how the jurisdiction will ensure that bond proceeds are used for the purpose of this proposal.

I am going to ask both of you gentlemen. Dr. Zimmerman, if you care to comment, please do, too. What do you think of that lan-

guage?

Mr. MANNING. Mr. Chairman, I can see the regulations coming now. I can see regulations about that thick. If I make a decision to have or not have a capital expansion program and it is bent because I have to do so in a way that conforms to complex Federal

regulations, then I am not doing my job.

For example, the test that will ultimately be written into some regulation that will enable me to identify my school building as the building which would not have been built but for Federal assistance, is going to be very, very difficult to apply. It also penalizes those districts that have already bitten the bullet and attempted to go and repair and renew their schools. There is no logic to that.

There also is a whiff running through the administration's program that these resources that you may have at your disposal will be disproportionately spent based on policy judgments made here at the Federal level rather than the judgments that I have to be accountable for back in Red Clay. I do not think that is a good idea,

either.

The CHAIRMAN. Thank you.

Mr. Visiedo?

Mr. VISIEDO. Mr. Chairman, my suggestion has a little bit of a different twist. I agree that it is critical for school districts and schools to be as free of regulatory obstacles as possible. That was

part of our problem.

By the same token, I acknowledge the fact that, if we create an environment that incents—and I recognize that is a slippery slope, but if we create an environment through some Federal initiatives that incents school districts to prove certain levels of efficiency before they access some of that money in order to be accountable. I think reasonable people can reach reasonable conclusions. I think you can achieve something like that.

I would not expect the Federal Government to make some additional dollars available to a local school district without having to be accountable for it. So I think we could probably do that. I have the same caution as Mr. Manning about not having the Federal Government sort of take over and create another series, because I

have lived that environment.

But, by the same token, it is doable. I experienced that first-hand after Hurricane Andrew, when we had a great deal of support from the Federal Government in that area and there was a lot of regulatory compliance that had to take place. But it was worth every dime because we had money at the time that we needed.

Let us not lose sight of what we are doing here. We are trying to create a better environment for children to learn. And if some regulatory compliance comes along with that, I think at the end of

the day, that is what the whole purpose is all about.

The CHAIRMAN, Dr. Zimmerman?

Dr. ZIMMERMAN. I would say that regulation usually is the vehicle by which the Federal Government is attempting to implement its targeting or policy objectives. So it is not like, if they are done

well, that they are not accomplishing anything.

In relaxing them, basically one has to look to see if we are sacrificing anything in terms of our Federal policy objectives by relaxing the regulations. That is an empirical question in each particular instance.

Mr. Manning. Mr. Chairman, may I supplement my answer?

The CHAIRMAN. Yes, please.

Mr. Manning. I failed to point out that, even if Federal assistance is absolutely policy neutral, I still have a host of regulations with which I must comply if I want to build a building in Delaware because I have the State government to contend with, and its regulations are complete, shall we say.

So it will not be the case that, if Federal assistance is offered on a very neutral basis, that school districts like mine will be unrestrained in what we must prove before we embark on a capital pro-

gram.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Thank you, sir. Thank you again for wonderful testimony. Dr. Zimmerman's note about the eight percent

growth is very impressive, indeed.

You do not have to answer this, but I think you are right that we are talking about regulatory matters. What confidence would you gentlemen, as educators, have in the regulatory wisdom of a government that, in 1994, said the United States will be first in mathematics and science by the year 2000? Would you say these are people with a hard grasp of reality, to be depended on to know what you need?

Mr. VISIEDO. Do you really want us to respond to that? I lived those regulatory times. I think, clearly, there is skepticism at the local level in school districts. There is no question about that. So I think the legitimate answer to that is, there would be some legitimate skepticism there. I think, however, and forgive me if I am out

of line with my own personal opinion-

Senator MOYNIHAN. That is what you are here for, sir.

Mr. VISIEDO. There are some legitimate, very critical nature problems that certain school districts have. In some cases, they are caused by themselves. In that case, I have a smaller tolerance level for them. But in other cases is what I experienced personally, because of immigration, that there was a very serious human need, and assistance at that point in time would have been welcome.

Senator MOYNIHAN. But regulation? I do not know. You do not have to answer that. In 1977 in this committee we introduced the Tuition Tax Credit proposal, which would have enabled the growth of things like charter schools. Senator Packwood and I, you, sir, and Senator Dole. It passed the House, and almost passed the Senate, but doctrine got in its way. The underground currents of doctrine here are so powerful, yet we do not even know about them.

I want to raise a question and a point that I think is sometimes missed. Mr. Manning, Mr. Visiedo, your school boards are elected,

are they not?

Mr. MANNING. Yes, sir.

Mr. VISIEDO. Yes, sir.

Senator MOYNIHAN. Do Democrats run against Republicans?

Mr. MANNING. Not knowingly.

Senator MOYNIHAN. Not knowingly.

Mr. MANNING. In my county, they do not. It is not a partisan

thing in Delaware.

Senator MOYNIHAN. Yes. We have in this country a parallel government called school boards. It is one of the most extraordinary things. I think of myself, from New York. And our counties upstate, our actual districts, the school board election takes place in May so it has nothing to do with the general elections for party positions, the government positions, the other government, in November.

People put together parties called The Better Reading Party, or things like that. But they serve without pay. They have the awesome and singular power of government, which is the power to tax.

They do it wonderfully well.

It seems to me we do not inquire enough about, how does this happen. If we got something like this that worked so well, I do not know, but I think it is singular in the world right now. Is there anything like it anywhere else?

Mr. VISIEDO. I do not believe so.

Senator MOYNIHAN. Sir?

Mr. MANNING. We have a system very much like you describe. We are anticipating elections this May. They are bipartisan, in the sense of Republican and Democrat. My salary is exactly what you describe: zero. It was very nice of you to point out the nice things

about that form of governance.

Now that you have done that, I have to say, though, that those of us who have been at the helm for the past 30 years really have not done as good a job as we should have. And when you asked your question about what I think of a government that just announces that, by fiat, we will achieve this level of performance in math and science in a very short period of time, realizing that the fact is that we are woefully behind, as we are, I would at least congratulate that government for setting the standards high, because one of the things we have not done in public education is raised the bar nearly enough. So, it may have been an unrealistic goal, but at the same time, under the guise of setting realistic goals for public education we have often set the bar too low.

Senator MOYNIHAN. Could I just say, Mr. Chairman, and I do not want to trouble these able people, but I was one of those who negotiated the agreement with what was then the U.S. Catholic Welfare Conference that brought about the Elementary-Secondary Education Act of 1964, which, as you will recall, was Federal aid to education as the baby boom entered the first grade, and such.

We had a solemn understanding that private schools would share in Federal aid, and they never got a penny, excepting for those hapless children who are led across the street to a trailer where they can learn mathematics without being infected by Papish doctrine, or whatever. I say to you, Federal aid, yes. But we have to be very careful with the restraints we put on because they are ideological, doctrinal, and hidden. You do not have to agree, but I think you recognize that. Mr. Manning. I think there is an amen coming from this end of the room.

Senator MOYNIHAN. Careful about amen. [Laughter.] Thank you very much, Mr. Chairman. And thank you, gentlemen, very much.

Mr. MANNING. Thank you, Senator. The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. I would like to make a couple of comments before asking a question. Dr. Zimmerman talked about the fact that, at the State and local level, judgments have to be made and priorities set as to how to allocate scarce resources. I think we learn some lessons over the past few years in the area of transportation. Our colleague, Senator Moynihan, helped educate us there as he has in so many other areas.

That is, that, one, we were systematically under-funding most of our transportation infrastructure, and we have seen the results of it. We see the results of it in overcrowded interstates, we see the results of it in the decline of our mass transit systems, so what we are seeing in schools may be an equitable allocation of inadequacy

vis-a-vis other areas of infrastructure.

The second thing that Senator Moynihan helped us understand is that one of the fundamental facts that has to be recognized is that financing infrastructure, whether it is transportation or schools, through the traditional methods is probably going to be a prescription for continued inadequacy. In the 1991 Surface Transportation Act, he included a provision that set up a commission to look at innovative ways to finance transportation.

In a very short period of time, that has resulted in State infrastructure banks, which are allowing States to multiply their Federal highways funds, a whole raft of other creative financing which you can see one result of on the road from here out to Dulles Airport. So I think that we have got to think outside the box, unless we are prepared to accept as a permanent future inadequate public

infrastructure.

Thus, I am intrigued with what Mr. Visiedo is doing in terms of some creative applications of a public/private partnership to education. It seems to me that this is also important, as we are beginning to look at schools in a different way. My own definition of a school is a physical place in which activities that enhance the development of children and their families take place.

Education is the primary of those activities, but not the exclusive. There are other things that are important for the development of children that can be accommodated effectively at that physical place called a school, such as after-school programs, health programs, and other things that are important to families and chil-

dren.

We are seeing schools being established in the workplace. In the county in which Mr. Visiedo and I live, one of the largest insurance

companies now has on-site a primary public school.

We need, at the Federal level, it seems to me, to at least not be a barrier to those kinds of things by having non-doctrinal and nonstatus quo oriented ways that can be accessed by State and local government to push the envelope of creativity.

So with that background, Mr. Visiedo, we did not have the access to private activity bonds when you were involved with the Pem-

broke Pines school that you described in your opening testimony. Does this indicate that we do not need this particular form of financing, that you can accomplish this without it? Or how would private activity bonds have assisted you at Pembroke Pines; how

might it assist you in other school construction projects?

Mr. VISIEDO. Senator, I think it would be a tremendous bonanza to the kind of work that we have achieved in Pembroke Pines. I think, for purposes of the committee, I would like to explain that the partnership with Pembroke Pines is between our company, which is a private company, the City of Pembroke Pines, which is a municipality, and the local school board. What we have done, is we have literally constructed a brand-new, State code-compliant elementary school, and are currently finishing a middle school.

Next year, we will be building a 1,200 seat high school, along with a regional county library and a Broward Community College complex, all through a public/private partnership for less cost per square foot and per student than I was ever able to achieve through the Dade County schools, or even Broward County schools.

One of the reasons we have been able to do this creative approach is because the city of Pembroke Pines is a growing city and has good capacity for borrowing and paying debt service, and we have worked that.

However, a lot of other municipalities could help the local school board create these educational institutions that the Senator described and relieve school overcrowding at substantially less cost

per student station if some of these things were available.

I would think, Senator, that probably a whole variety of municipalities through the State of Florida would avail themselves. Right now, the City of Kissimee is in the process of doing that and we are negotiating with them. If, in fact, that would happen, and they are looking for financing options, that may well be a very viable financing option for that city.

Senator GRAHAM. Thank you. The CHAIRMAN. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much. I appreciate your having the hearing. I apologize. I just got in at the last part of it.

Let me just, Mr. Chairman, say from the outset, I have strong reservations about the President's proposal on school financing

with tax credits.

Let me ask the panel. I am not sure who to direct this to, so I will just open it up. Is there any restriction right now? Right now you can build schools with tax-exempt bonds. Are you able to do that? Is there a restriction on that? Is there something that is keeping you from doing that? Yes, Mr. Manning?

Mr. MANNING. The hurdles that I would have to climb over in order to build a school include, first of all, persuading the citizens of my school district that they ought to raise their taxes to service

the debt that I am about to incur to build that building.

But, even before I do that, I have to travel 45 miles south to Dover, our State's capital, and go through a very prolonged and difficult process to convince people who do not care about my district any more than any other citizen outside of Red Clay that they should let me build a school building. So even before I begin to

imagine whatever Federal regulations push the question one way or another, there are a series of hurdles that I have to climb over in order to build a school building.

Senator NICKLES. But if you have local support you could build,

basically, with existing financing and tax-exempt bonds.

Mr. Manning. Yes.

Senator NICKLES. The President's proposal would say "in targeted areas." I do not know if yours would be one of those targeted areas. I do not know if my State would even qualify as a targeted area. Maybe some areas would, and some areas would not; the Federal Government would decide.

But it would replace the tax-exempt bond financing with the tax credit, which basically, instead of having the school district pay the interest on that bond, it would have the Federal Government. You would get an interest-free loan, thank you very much, courtesy of the taxpayers, and the taxpayers who purchased these would get a tax credit. Is that right, Dr. Zimmerman, something like that?

Dr. ZIMMERMAN. Yes. At the moment, typically, a tax-exempt bond provides about a 25 percent subsidy or payment of State/local interest costs, but the tax credit bonds would provide 100 percent

subsidy of the interest costs.

In terms of, are there any restrictions on the ability of State and local government to issue bonds, traditional governmental bonds as the Tax Code calls them, there is absolutely no restriction in the Federal Tax Code on the ability of State/local governments to issue

an unlimited amount of bonds for public school finance.

The restrictions, as was emphasized, tend to, at the State/local level, have ceilings on the amount they can borrow. Oftentimes, ceilings that were established at a time period that is not particularly relevant to today's modern economy. They may have supermajority voting requirements, they have to go down and see the State. But those are not Federal restrictions, those are State and local restrictions, over which Federal jurisdiction is not present.

Senator NICKLES. I appreciate that comment. I might mention, I have talked just recently to the Governor of Nevada. He said they were doing a lot of school building. A lot of school building. And they are doing it basically under the existing tax-exempt proposal, and it is working. He said, we do not need these tax credits. To increase the subsidy, basically, from I guess, you said, an average of around 25 percent to make it a 100 percent tax credit, I think, is a serious mistake.

Mr. Chairman, I just wanted to let that be known. The President has a \$11-some billion proposal that I think is draconian in its outreach, plus the qualifications. As I said, I do not know if my State

has areas that would qualify or not.

So, again, we would have the Federal Government deciding, well, this area qualifies, so you are going to get a tax credit, a 100 percent deduction, basically, off your taxes for this income, for holding this bond, compared to the existing tax structure we have nationwide, which is fair, which is locally controlled, that gives people a deduction on interest from Federal and State.

To me, the present system is much more equitable, much fairer across the country. To go into this tax credit with the expense that is involved, I think, would be a serious mistake. So, I wanted to

let the Chairman know that I think the President, in this case, has made a serious mistake.

I appreciate our panelists, and apologize for being a little bit late. The CHAIRMAN. Well, thank you very much, Don. I particularly want to express my appreciation, and the appreciation of the com-

mittee, for the excellence of your testimony today.

I am sorry that other things prevented you from hearing it, Don, because Dr. Zimmerman made a very excellent presentation of the current situation. We are, indeed, indebted to the other two gentlemen who have devoted so much of their time and professional life to probably the most important problem we have, the education of our children.

Thank you very much. We hope to keep working with you as this

legislation proceeds.

The CHAIRMAN. The committee is in recess.

[Whereupon, at 12:18 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

PREPARED STATEMENT OF HON. KENT CONRAD

Mr. Chairman, I commend you for turning so early in this session to the important issue of education tax incentives. It illustrates the consensus that has developed around the notion that we have an obligation to help state and local govern-

ments modernize schools.

Rural communities and Indian reservations, which are major concerns in a state like North Dakota, have special problems when it comes to schools. The Administration's proposal to provide \$25 billion in school modernization bonds recognizes these unusual concerns by allocating half of the bond authority to the 100 school districts with the largest number of low-income children and the other half to states based on the Title I formula. In addition, \$400 million in bonding authority would be set aside for the construction of facilities on Indian reservations.

In 1995, the General Accounting Office estimated that it would cost more than \$112 billion to upgrade the elementary and secondary school facilities across the nation. The GAO study also examined every state in order to estimate the number of facilities in need of repair. In North Dakota's case, the study reported that 88 per-

cent of the schools were in need of an upgrade or repair.

Dr. Wayne Sanstead, North Dakota's State Superintendent of Schools, told me in a letter earlier this week that the cost of making the state's public school facilities state-of-the-art would be approximately \$420 million. In the context of the current North Dakota economy, that is a huge expenditure. I am submitting for the record Dr. Sanstead's letter and a summary of a facilities report conducted for the North Dakota Department of Public Instruction.

With respect to the particular concerns of schools on Indian reservations, the Administration's budget request includes funding and bonding authority for the Indian School Construction Bonding Initiative. Under that proposal, nearly \$400 million in zero-interest bonds would be authorized for issuance over a two-year period. Tribal governments would issue the bonds, and bond holders would receive tax credits-

not interest over the life of the bond.

The fact is that tribes in the Dakotas are unlikely to have enough money to back their own bonds, and it is unclear at this point if any Dakota schools will be on the new school construction priority list. However, the bond program may prove use-

ful if it helps speed up construction of the schools on the priority list.

Mr. Chairman, I look forward to working with you to help ensure that the committee's consideration of education tax incentives takes into account the critical needs of both rural communities and tribal schools.

Attachment.



Department of Public Instruction

600 E Benjevard Ave., Dept. 201, Bismarck, ND 58505-0440 (701) 326-3246 Fax - (701) 328-2461 http://www.dpi.stoca.nd.m

Dr. Wayne G. Soneteen State Superintenden

March 2, 1999

The Honorable Kent Conrad United States Senate 530 Hart Senate Office Building Washington, DC 20510

Dear Seastor Conrad:

I am writing this as a follow-up to our recent conversation concerning the Senate Finance Committee's plans to conduct hearings regarding funding for school modernization.

I am attaching the executive summary of a school facilities inventory completed by the Department of Public Instruction with assistance from the Barton Malow Company. The study was done in the fall of 1994 and the report was issued in January of 1995.

While some school construction has taken place since that time there is no reason to believe that the basic assumptions outlined in the executive summary about North Dakota's needs for school building renovation and upgrading have changed significantly. As the executive summary indicates the total projected costs to bring North Dakotas 453 public school facilities up to state-of-the-art facilities would be approximately \$420 million or nearly one million dollars per building.

Our small rural North Dakota school districts in particular have extensive and potentially expensive school renovation needs which have been consistently deferred because of budget constraints due to fluctuations of our agricultural economy and the impact of significant declining enrollment which further erodes school districts funding base.

Even in those few circumstances where some of these rural districts consider consolidation school renovation would still be needed. In fact, consolidation that appears to be required in some rural areas to sustain school programs will in turn require construction of updated larger facilities to accommodate consolidated enrollments. Clearly, North Dakota, and in this case, especially rural North Dakota would benefit from federal financial assistance for school renovation and construction.

Rebard for the Dool Rooth Labo, ND (191) palentes School for the Silinal Grand Purts, NS (701) 795-3700 Sum Library Stanovsk, NO (701) 338-3472 Dir of Independent Souty Pargo, ND (701) 231-4440 In addition, North Dekota's Native American reservation schools are in some cases in desperate need of renovation and upgrading. While they have access to some funding through other federal programs, our experience is that the money available through those programs is not adequate and not available in a timely fashion. These districts would also benefit from a general federal infusion in the area of school construction and renovation.

In sum, I am encouraged and strongly support your effort to pursue this source of funding to help our hard-pressed agricultural areas. If I can provide further information or be of advocacy assistance in this congressional effort please do not besitze to contact me at any time.

I look forward to visiting with you and your staff when I once again preside over Council of Chief State School Officers Legislative Committee deliberations on March 15 and 16.

With best wishes,

Dr. Wayne G. Sanstead State Superintendent

Facilities Report

for

North Dakota Department of Public Instruction



January, 1995



North Dakota Department of Public Instruction

Executive Summary

Purpose

This Facilities Report is intended to provide the North Dakota Department of Public Instruction with current as well as historical data on public school facilities within the State. The information contained in the report is based on survey results submitted by the Districts. There are eleven districts, listed at the end of Section 1, which did not submit survey forms. The survey forms were developed by Barton Malow Company and distributed by NDDPI.

Contents

The report has been divided into four sections to provide a variety of information. The sections, with a brief description of contents, are as follows:

- Section 1 Schools listed sequentially by identification number: county / district / plant.
- Section 2 Schools listed alphabetically by District showing enrollments and grade levels within the school.
- Section 3 Schools listed alphabetically by District with the building area and dates of construction of the original building and later additions.
- Section 4 Schools listed alphabetically by District with "broad brush" budget costs for renovations/maintenance work in the following categories.

Category

Site Work
Building Exterior
Roofing
Handicapped Accessibility
Teaching Areas
Non-Teaching Areas
HVAC Systems
Plumbing Systems
Electrical Services
Electrical Systems

Scope of Work

paving, site lighting, etc.
windows, entrance doors, exterior walls
roofing
toilet rooms, drinking fountains, elevators, etc.
classrooms, science labs, music rooms, etc.
corridors, toilet rooms, media center, etc.
heating equipment and piping, exhaust systems
plumbing fixtures and piping
electrical service capacity and distribution
PA, clock, and fire alarm systems

Some highlights of the total survey include the following:

- There are 246 districts in the State, including the eleven non-reporting Districts: 181 of those districts have only one school building.
- The total square footage of reporting buildings is almost 22,000,000 s.f. contained in 434 buildings. Nearly 38% of the total square footage, approximately 8,250,000 s.f., is contained in the eight largest school districts: Bismarck, Dickenson, Fargo, Grand Forks, Jamestown, Minot, West Fargo, and Williston.
- The total budget for renovation/maintenance work is approximately \$420,000,000 or nearly \$1,000,000 per building.

North Dakota Department of Public Instruction

Executive Summary

Building Age Breakdown Summary

As can be expected, in the nearly 22,000,000 s.f. of facilities space, the age of the buildings varies greatly. The square footage area of buildings, grouped by periods of construction, has been listed to show a "feel" for the age of the buildings. The periods of construction indicated are in twenty year increments. The building additions are considered independent of the original building construction to more accurately reflect the age of the construction in relation to the overall area. The age breakdown of the eight largest districts mentioned above are also shown. The square footages have been rounded off.

Date/Age of Construction	State Total	Percent of State Total	Eight District	Percent of District Total
1900 - 1925 (over 70 yrs. old)	1,675,000	7.6%	500,000	6.0%
1926 - 1945 (51-70 years old)	1,620,000	7.4%	530,000	6.4%
1946 - 1965 (31-50 years old)	9,115,000	41.7%	3,045,000	36.9%
1966 - 1985 (11-30 years old)	2,370,000	10.8%	2,375,000	23.5%
1986 - present (0-10 years old)	6,825,000	31.2%	1,660,000	20.1%
portable units	275,000	1.2%	139.000	1.7%
	21,880,000		8,250,000	

Renovation/Maintenance Cost Development

Sections 1, 2, and 3 are merely arrangement of information provided on the survey forms. The Section 4 budget costs were developed in a methodical and consistent way but are very "broad brush" due to the limited amount of information provided by the surveys. The standards and unit costs used to develop the budget costs are included at the end of this section. Following is a brief synopsis of the key elements and methods used to develop the budget costs.

- Spaces within the buildings have been assumed to be of uniform size for each space regardless of whether the school is an elementary school, middle school, high school, or other grade structure building. For example, regular classrooms have been considered as 800 s.f. each. Similar space standards were established for all spaces on the survey forms.
- Unit costs for each type of work were developed. A single cost for complete renovation of each specific space (i.e. classroom, media center, toilet room, etc.) was developed based on the total space size. Some items, such as roofing work are based on square foot costs.

North Dakota Department of Public Instruction

Executive Summary

- The survey forms provide the schools' rating of the area or specific item based on a 0
 (No Work Required) to 3 (Total Renovation/Replacement Required). The unit costs
 described above are based on a 3 rating for that particular item.
- The cost of a particular item is proportionate to the rating for that item (i.e. a 3 rating requires 100% of the total replacement cost while a 1 rating requires only 33% of the replacement cost). Roofing work for example would be the area of the roof times the roofing square foot cost times the rating factor. The cost for classroom renovations would be the unit cost for complete classroom renovation times the number of classrooms times the rating factor for the classrooms.
- Mechanical and electrical costs are based on square foot costs for the entire building area since those systems serve the entire building. The lighting renovation costs are included as a portion of the space renovation costs.

Listed below are the standard room renovation costs and building system unit costs used in developing the Renovation/Maintenance budgets. The totals for each particular renovation were combined with similar items to fall into one of the ten work categories identified above.

Space	Renovation Cost per Space
classroom (including equipment and lighting)	\$26,500 per room
science room (including equipment and lighting)	\$46,000 per room
art room (including equipment and lighting)	\$42,000 per room
home ec./vocational room	\$44,000 per room
music room	\$45,000 per room
media center	\$75,000 per room
administration/counselor space	\$30,000 per bidg.
gym	\$120,000
cafeteria or multi-purpose room	\$90,000
kitchen	\$42,000
toilet rooms	\$15,000 per bldg.
corridors (25% of building area times)	\$10 per s.f.
auditorium (number of sests times 15 s.f./seat)	\$54 per s.f.
•	
Item or Building System	Unit Cost
site paving (number of spaces times 450 s.f/space)	\$ 3 per s.f.
site athletic fields and equipment	\$35,000 per bldg.
bandicapped accessibility	
building entrance	\$ 3,000 per bldg.
elevator (if multi-floor building)	\$75,000 per bldg.
drinking fountains	\$ 3,000 per bldg.
toilet rooms	\$15,000 per bldg.
roofing	\$ 5 per s.f.
building entrances	\$ 20,000 per bldg.
windows	\$ 48 per s.f.
bollers	\$ 1.25 / s.f.
air-handling units	\$ 1.50 / s.f.
heating piping and insulation	S 4.25 / s.f.
beating terminal devices (radiators, fla-tube radiation, etc.)	\$ 1.25 / s.f.
plumbing fixtures	\$ 1.50 / s.f.
electrical service	\$ 0.35 / s.£.
electrical distribution	\$ 1.30 / s.f.
fire alarm, clock and PA systems	\$ 1.45 / s.f.

North Dakota Public School Enrollment Patterns

	All O	her Dist	ricts		
·	1973	1994	1998	2011	98-2011 Diff
	(356)	(228)	(214)	?????	·
Total Enrollment	76,295	52,085	49,024	31,756	17,268/35%
Average Enrollment K-12	214	228	229	48 Chapa	٠
Percent of Total Enrollment	56	44	43	33.6	

North Dakota Public School Enrollment Patterns

	15]	Largest Di	stricts			
	1973	1994	1998	2011	98-2011 Diff	
Total Enrollment	60,109	66,564	64,905	62,894	2011/3%	49
Average Enrollment K-12	4,007	4,438	4,327	4,193		
Percent of Total Enrollment	44	56	57	66.4	•	

PREPARED STATEMENT OF ALEXIS GARLAND

Good morning Mr. Chairman and Members of the Committee, my name is Alexis Garland. I live in New Castle, Delaware, and I am a Procurement Coordinator at

Hewlett-Packard Company in Wilmington, Delaware.

Hewlett-Packard Company is a leading global provider of computing, Internet and intranet solutions, services, communications products and measurement solutions, all of which are recognized for excellence in quality and support. HP has 122,800 employees and had revenue of \$47.1 billion in its 1998 fiscal year.

Thank you for the opportunity to discuss the reasons my company and its employ-ees would benefit from legislative action making Section 127, the employer-provided educational assistance program, a permanent part of the tax code. In addition, I want to you to know why restoring employers' ability to provide graduate as well

as undergraduate assistance is so important.

Section 127 March 1, 1999 Page 2 Today I'm telling my story, but I'm just one of over 5000 HP employees who has taken advantage of Section 127 to better themselves. Therefore, it is on behalf of all of those employees that I appear before you.

Educational assistance and Section 127 helped me earn my bachelor's degree in

Business Management and, therefore, helped me provide a better life for my family. I graduated from high school in 1970. I was one of five children and college was not an expense my family could afford. So, I started my career working two parttime jobs. Of course, having no benefits, I soon sought a better opportunity and was hired by ICI America as a file clerk.

At the time, I thought to myself, "I have it made! I've started a real career with a real company." However, those thoughts were shattered three years later when my division was sold and was moved to Texas. I was unable to move with the new

company, so I lost my job.

Staring unemployment in the face, I was lucky to land a secretarial position with a small rental company. It was then, after having to take a cut in pay, that the importance of continuing my education became crystal clear. I realized that change was inevitable, that business and technology would continue to move at lightning speed, and that I needed to improve my skills to survive. I knew that a college degree would give me the edge I needed to advance. However, I couldn't afford the expense and assistance wasn't available.
Fortunately, I was later hired as a file clerk for DuPont. After the birth of my

second child and a number of years as a clerk and data-entry operator, I decided it was time to take advantage of the company's education assistance program and Section 127 to make my dream of a degree a reality. So, in 1985, at age 33 1 began

my studies.

Several years later, turbulent business conditions hit DuPont and I found myself "downsized" out of a job. Fortunately, as part of my exit packet, I was given outgoing educational assistance. For the next year, I worked for a temporary agency and used the funds to complete my Associate degree.

With my Associate degree in hand, I was able to secure a position at BT&D Technologies as a customer service representative. The company offered education assist-

ance, which I immediately used to continue college.

Eight months later, BT&D was sold and fortunately, the buyer was Hewlett-Packard. I found that HP offered excellent education assistance and great opportunities for advancement, so I happily joined the company in 1993.

Three years later, in May of 1996, 1 completed my bachelor's degree. As I walked

onto the stage at Wilmington College, I thought about the 10 years that I spent at-

the diag classes, writing papers and taking tests; all in my "spare" time.

My son was 5 years old when I started my degree and 16 years old when I graduated. I had worked full time; I had raised my family; and I had earned a college diploma.

Obtaining my bachelor's degree was not easy, but it would not have happened without educational assistance and Section 127. Yes, I missed precious time with my family; I gave up numerous social activities; and I drove a car with over 150,000 odometer miles to my graduation. However, the benefit of building a better future

for my family far outweighed any sacrifice we endured.

Section 127 was in place during most of the years that I was in college. I understood that, as long as I stayed within the dollar limit, I wouldn't have to pay taxes on my educational assistance. However, when Section 127 lapsed, I viewed the possibility of being taxed on my educational assistance as a contradiction and a disincentive. On one hand, government was talking about the importance of education and saying that workers' skills needed to be upgraded so that the nation would stay competitive. On the other hand, by taxing the funds, they were saying that we had to be financially penalized. Making Section 127 a permanent part of the federal tax

code, just makes sense—because everyone wins.

Last year, armed with my bachelor's degree, I was the successful candidate for a procurement coordinator position. The new job moves me one step closer to my current goal of becoming a commodity manager. However, in speaking with my supervisor, I recently learned that an MBA is desired for the job.

The thought of pursuing a Master's degree is exciting, but may not be realistic. As a single mother with a college age son, finances are tight. The only way that I could even consider attending graduate school would be with the assurance of educational assistance that included tax exclusion. However, since Section 127 doesn't cover graduate courses, I don't think it would be easy for anyone to give me that assurance today.

As I stated earlier, I know all too well that change is inevitable, that business and technology are moving at lightning speed, and that job survival is dependent upon continuously improved skills. Educational assistance and Section 127 are the tools that can help thousands of people, just like me, to succeed. Therefore, it is my hope that Congress will make the educational assistance tax exclusion a permanent

part of the federal tax code for graduate as well as undergraduate level courses.

In closing, I want to thank Chairman Roth, ranking member Senator Moynihan and the rest of the committee for your hard work and support in making Section 127 permanent, and for including graduate as well as undergraduate education. I would be happy to answer any questions that the Committee might have at this

time.

PREPARED STATEMENT OF HON. BOB GRAHAM

Thank you.

I would like to begin by thanking the Chairman for giving us the opportunity to discuss these important issues. In my opinion, the topics we are discussing today are some of the most important that this committee will address this year.

Today I would like to discuss two of our nation's top education priorities. The first is making college more affordable for middle and lower income families. Forty-eight states have created prepaid college tuition programs or college savings plans to help families save for their children's higher education. For the past three years Senator McConnell and I have worked together to protect these valuable programs from burdensome taxation. included ensuring that these programs are tax deferred. ver, it is our ultimate goal to make prepaid college tuition However, plans and college savings programs 100 percent tax free. McConnell and I have already introduced legislation that would accomplish this goal. In addition, I have recently worked with Senator Sessions on a plan that would extend these privileges to prepaid college programs for private colleges and universities. Both Senator McConnell and Sessions are here this morning to talk about this issue in greater detail.

I would like to move on to another major educational challenge facing our nation --- the need to address the overcrowding and deterioration that exists in many of our nation's public schools. Rapid population growth, the need to repair older crumbling schools, and the task of modernizing our schools for the 21st Century are straining the ability of local communities to keep up with construction and rehabilitation needs.

Education is rightfully a state and local matter, but the Federal government can play a helpful, non-intrusive role in assisting communities overwhelmed by explosive increases in student We at the Federal level should help empower local school districts to find innovative, cost effective ways to finance new schools and repair aging ones.

The problem of school construction and rehabilitation is well documented.

The U.S. Department of Education estimates that 6,000 new schools must be built by 2006.

The General Accounting Office estimates it will cost more than \$112 billion to bring existing education infrastructure up to a state of good repair. This report was brought to us three years ago. However, the federal government has still done very little to help local and state governments address this problem.

I might add that my own State is gaining 60,000 new students each year. And by the end of the decade, Florida's student enrollment will have increased 25 percent more than the population as a whole.

So, how do we at the federal level help our state and local governments confront this huge financial burden? First of all, I believe that we should be providing a "cafeteria plan" of options to choose from in order to enable local and state governments to have a variety of financing tools available to them. An innovative means of financing the building or renovation of a school in an urban area like Miami won't necessarily be the best option for a rural town in Iowa.

Today I am introducing bipartisan legislation with Senator Grassley that provides four different alternatives to ease the burden of financing public school construction. We are joined by Senator's Kerrey, DeWine, Hutchison, and Torricelli.

One alternative is to add educational facilities to the list of 12 types of facilities that can use private activity bonds. As you can see these bonds have been used to finance a wide range of public projects: airports, docks and wharves, mass commuting facilities, facilities for the furnishing of water, sewage facilities, solid waste disposal facilities, qualified residential rental projects, facilities for the local furnishing of electric energy or gas, local district heating and cooling facilities, qualified hazardous waste facilities, high-speed inter-city rail facilities, and environmental enhancements of hydroelectric generating facilities.

The importance of adding <u>public</u> educational facilities to this list is that these bonds would be tax exempt. And I emphasize the word PUBLIC, because PRIVATE non-profit elementary and secondary schools already have the ability to issue tax-exempt facility bonds. Public schools should have the same tax treatment. Our legislation gives public schools parity with private schools.

The public/private partnership in school construction through the use of private activity bonds is already being used in the Canadian province of Nova Scotia. Here is how it works: a private corporation builds the school and leases it to the school district at a reduced rate. The private entity supplements the cost of the building by leasing it for other uses during non-schoolhours.

This approach has been a success. According to a study by Ron Utt at the Heritage Foundation, 41 new schools have either been completed or approved for construction under the Public/Private Partnership program. In the next three years, Nova Scotia expects to replace 10 percent of its schools through such partnerships. I will submit Utt's report for the written record.

I am optimistic that enabling communities in the United States to have that same opportunity will foster the same results.

Another portion of this legislation would help relieve some of the burdens on small and rural school districts.

Current law relieves small issuers of tax-exempt bonds for qualified school construction from onerous federal arbitrage regulations, but more relief is needed. The calculations required to determine the amount of arbitrage rebate are extremely complex and often require that a local government hire an outside consultant. Despite the trouble and expense of compliance, rebate amounts are usually quite small. Local governments sometimes spend much more to comply with the rebate rules than the amount actually rebated to the Treasury.

My legislation would permit school districts to keep funds earned on bond proceeds instead of reimbursing the Treasury Department if the bonds offered by the district totalled less than \$15 million that year, or if the bonds are spent within four years.

Changing current tax laws affecting both private activity bonds and arbitrage would help local school districts throughout the United States. Our legislation would foster even more innovative approaches to finance the building and refurbishment of our public schools. Such public-private partnerships would speed construction of new schools and reduce costs to communities.

State and local governments are already looking for creative new ways to finance schools. Today you will hear from Octavio Visiedo who I proud to say is from my home state of Florida. He began his career in education as a bus aide back in 1971 with the Miami-Dade Public Schools, the fourth largest school district in the country. Since then he's been a teacher, a principal, and the district's superintendent. Currently he is working in the private sector as President of Haskell Educational Services. There he has been involved with planning and developing creative ways to fund public school construction. I look forward to hearing from Mr. Visiedo this morning, and thank him for sharing his ideas with this committee.

Finally, I would again like to thank this committee for giving me the chance to testify this morning. These issues are of great concern to me, and I am hoping that we can come to some agreement on both this year.

Thank you.

age Foundation

No. 1257

HOW PUBLIC—PRIVATE PARTNERSHIPS CAN **FACILITATE PUBLIC SCHOOL CONSTRUCTION**

RONALD D. UTT, PH.D.

In the United States, the funding, construction, and renovation of public elementary and secondary school buildings historically have been the sole responsibilities of state and local governments. But in recent years, the President and some Members of Congress have attempted to create new federal spending and lending programs to assist communities in meeting their school facility needs.

To date, none of these proposals has become law, and school construction remains the responsibility of states and localities. The increased intensity and frequency with which these proposals are put forward, however, ultimately may help these efforts to prevail. Such an outcome could weaken the American system of federalism, increase federal spending and lending, and centralize in Washington yet another responsibility of local government.

Before this debate over who should pay for publie school construction is renewed in Congress, federal, state, and local officials would be well salvised to consider the innovative public-private partnership approach that has been adopted here and abroad. These partnerships allow communities to upgrade their public school facilities at substantially lower costs and in less time than purely governmental efforts typically require. In recent

years, for example, public school systems in the Canadian province of Nova Scotia, in Great Britain, and in some U.S. jurisdictions have implemented programs or pilot projects to encourage

private investors to construct (and own) "public" school buildings to the school system's specifications. In turn, the private partner leases the facility to the school system at rent levels below what the public school system would have incurred had it built and operated the school.

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A CASE STUDY IN **EFFECTIVENESS**

Nova Scotia offers the clearest example of how public-private partnerships facilitate school construc-



tion. For example, by the end of 1998, as many as 41 new schools had been either completed or approved for construction under the Public Private Partnership program. In the next three years, Nova Scotia expects to replace 10 percent of its schools through such partnerships. The schools are

"turnkey" operations—the facility is fully operational when the lease begins, complete with all classroom furnishings, such as desks, shelves, and chalkboards; computers wired to the Internet and the inter-school electronic network; furnished administrative offices; landscaping; and athletic facilities. The school system provides the teachers, aides, principal, and administrative staff and maintains full control over the curriculum and all other educational services and decisions.

The chief advantages of this arrangement for Nova Scotia's school system is the speed with which it is able to upgrade its school facilities and the average 15 percent savings it achieves through leasing arrangeme. to with the private developers/ owners. The school system leases the facilities for 20 years at a predetermined rent that is lower than the capitalized cost of construction and furnishings. Where the developer covers the additional costs and earns a profit is in the intensive use of the facility during periods in which it is not in use by the school system. In effect, the private developer/owner leases the facility to the public school system from morning to mid-afternoon, Monday through Friday, and for any additional after-hours or weekend use as negotiated. During the remaining hours of the day, as well as on weekends and holidays and over the summer when the facility otherwise would remain idle, the developer leases the classroom space to other education-oriented entities, such as for-profit trade schools and various civic, political, or religious groups, for preapproved purposes. The purposes are carefully spelled out in the lease to ensure that activities that are inappropriate to an educational facility used by children do not occur in the building.

THE POTENTIAL SAVINGS

If such an approach were implemented in the United States, the potential savings could be greater than the 15 percent Nova Scotia realizes because private financing and ownership of the structure would allow school systems to avoid additional costs imposed by federal and state mandates. Such mandates include prevailing wage

laws, environmental regulations, and minority setasides, which often add substantially to the costs of design and construction of publicly funded buildings. No such mandates exist in Canada, and the actual costs to construct private school facilities are just slightly less than the costs of public school construction. The rent savings there arise primarily from the intensity with which the facility is used for other purposes.

An indication of the potential construction cost savings that could occur through public-private partnerships in the United States was revealed by a newly opened public elementary charter school in Florida that teamed with a local design/building firm to construct its facilities. Using an approach similar to Nova Scotia's plan and money provided by the community to build the school, the per-student construction costs fell between 22 percent and 34 percent below the state average for constructing public elementary schools. These savings were due largely to a series of innovative design efficiencies jointly devised by the builder and school system.

LEGISLATIVE EFFORTS

Of the more than 30 school construction bills introduced in the 105th Congress, only one offers an innovative approach to public school renovation and construction by harnessing the energy, resources, and expertise of the private sector. The Public Schools Partnership Act introduced by Senator Bob Graham (D-FL) as S. 2397 proposed amending the federal tax code to expand the allowable uses of tax-exempt private activity bonds to include construction of privately owned school facilities leased to public school systems. If broadened to enhance its versatility, this bill could serve as the foundation for a legislative plan that encourages the creation of innovative publicprivate partnerships to build public schools more rapidly and at lower cost across the country.

—Ronald D. Utt, Ph.D., is Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation.

PREPARED STATEMENT OF HON, ORRIN G. HATCH

I applaud the Chairman for holding this hearing today. The issue of education is a critical in so many ways, and affordable education is a must for American families. The issues we discuss today have a far-reaching impact on the future of the American economy, our families, and the standard of living we enjoy.

Utah is in a unique education financing position. We have the highest percentage of school-age children and the lowest percentage of working age adults, which presents a funding challenge on both the state and local levels. Anything we can do through tax incentives to help families and the state make education more afford-

able is important.

I do have to brag a little about my home state—while Utah does not fare well under the current formula for federal education funding, Utah does more with less better than any state in the nation. For example, Utah is first in the nation in both advanced placement participation and performance on a per capita basis. Utah is second in the nation in the percentage of its adult population holdi z a high school diploma. These achievements in elementary and secondary education extend to higher education as well—and there are many more I could cite. I would just like to see what we could do with a fairer formula—but I'll make my speech on that at another time. Depending on the proposal before us, it could be a very long speech.

The first issue we must address is how to ensure that education is affordable to our families. Wherever I go, I hear again and again how the cost of education at today's colleges and universities is going up. As a father who has put six children through college, I know how parents are sacrificing to provide their children with a college education. In the past several years, we have done some good things to help families saving for education: allowing IRA withdrawals for education expenses, creating education savings accounts, created tax credits for education, allowed a deduction for student loan interest, and made it easier to utilize a qualified state tuition program.

Utah was one of the first states to adopt a qualified tuition program to allow parents and students to receive tax benefits for contributions to an account for college education. Programs like this have proven to be very beneficial in reducing the cost of tuition for students and parents who save for college. The testimony here today will give us some ideas for changes to existing incentives or the creation of new ones

to make higher education available to more families.

Another critical issue for the education system is school infrastructure. More and more of our school districts are crying out for our help to help them save the infrastructure of our school systems. Too many of our school buildings are crumbling and overcrowded. This is especially true for states like Utah with high population growth.

Utah has 40 school districts and 763 public schools. The \$350 million that Utah

will spend each year in new repairs come mostly from district tax levies.

The problem doesn't just stop with repairs, however. We must address the need for new schools. The high cost of construction is pushing too many of our students into overcrowded classrooms or portable facilities. In Utah, there are 1150 portable buildings in use. This represents 3% of the square footage dedicated to educational instruction. This doesn't mean that Utah is not building new schools. They are. Conservative estimates are that the state of Utah builds 10-15 new schools a year. In the Jordan School District alone, 6 new schools are currently under construction; and, in the rural area of the Washington School District, 3 schools are under construction. We must do something to help our state and local school districts address these problems.

But, it seems to me that there could be more creative ways of solving this problem than another big federal direct spending program. Congress has always shied away from funding bricks and mortar for very good reasons. And, we certainly do not want federal ownership of school buildings. But there is a federal role in helping to finance the necessary infrastructure for education. We are walking that fine line between tax incentive and federal subsidy, between leveraging resources and establishing a new form of financial dependence. I am sure that the testimony we hear

today will help us move in that direction.

I want to thank our witnesses for being here today to share their ideas. And, again, Mr. Chairman, I appreciate your holding this hearing today.

PREPARED STATEMENT OF SHIRLEY HUGHES

Chairman Roth, Senator Moynihan, members of the committee. I am Shirley Hughes, Senior Vice President, Human Resources, Ceridian Corporation.

Headquartered in Minneapolis, Ceridian is a leading information services company that serves the human resources, transportation and electronic media markets. I am testifying today on behalf of the National Association of Manufacturers (NAM) and the Section 127 Coalition.

The NAM is the nation's oldest and largest broad-based industrial trade association. Its 14,000 member companies, including approximately 10,000 small and medium manufacturers, are in every state and produce about 85 percent of American manufactured goods. Through its member companies and affiliated associations, the NAM represents every industrial sector with more than 18 million employees. The Section 127 Coalition is a diverse group of business, labor and education organizations that are committed to making the exclusion for employer-provided educational assistance found in section 127 a permanent part of the tax code.

First, thank you Senator Roth and Senator Moynihan for introducing legislation to make permanent the section 127 tax exclusion for employer-provided educational assistance, and to extend 127 to cover graduate education. The Senate Finance Committee has a history of support for section 127, and we thank the Committee

for its support of these provisions last year.

We appreciate the opportunity to discuss the importance of section 127, and the benefits to both employers and employees of reinstating graduate-level education and making this provision permanent. Ceridian has had a tuition aid policy since 1969. Like many other NAM employers, we view tuition support as one part of our company's commitment to education and training for some 10,500 workers across four separate businesses. As we approach the 21st century, a highly skilled, welleducated workforce has become even more important to improve productivity and competitiveness.

Mr. Chairman, our testimony today can be summarized in one sentence: making Section 127 permanent law and extending its coverage to graduate education is a win-win-win. It's a "win" for employees because they are permitted to exclude tuition assistance from their taxable income. It's a "win" for employers because it en-

ables employees to acquire additional education and skills and become more valuable assets. And it's a "win" for America because it helps raise educational attainment—a key driver of US productivity in the knowledge economy.

Though first enacted twenty years ago, section 127 is one of America's best investments in the future: in 21st century skills for 21st century jobs. We urge the Comments in the future of the comments in the future of the comments in the future. mittee to approve the Moynihan-Roth bill and we hope the Congress will enact it.

Mr. Chairman, at Vice President Gore's Summit on Lifelong Learning last month,

Secretary of Labor Alexis Herman said that "about half of all adults today have a high school degree or less." She went on to say that "when we look at the 10 fastest growing jobs of the future—almost all require a college degree or significant on-the-job training."

And the National Association of Manufacturers, in its just-released report entitled

The Skills Gap, found that, "There is a continuing, worsening skills gap in the manufacturing workforce." To address it, manufacturers plan to devote more resources

to employee education and training, including through tuition reimbursement.

Advances in technology, far from reducing human involvement in manufacturing and service industries, have created a demand for higher educational levels. For employees, that means fewer low-skill jobs and a substantial pay differential between low and high skill work. The wage gap between high school and college-educated workers is a high 85 percent. According to the 1996 Economic Report of the President, each additional year of post-high school education is worth 5—15 percent in additional committees. additional earnings. A high school diploma no longer is enough to get a good manufacturing job and earn a middle class living like it was in the 1950s and 1960s.

Today, that same worker is more likely to need a college degree.

Global competition also has produced a demand for a highly educated workforce. Beyond manufacturing, the need for well-educated—not just highly skilled—workers with the drive for lifelong learning is critical across all industries. Ceridian's information services businesses serve a variety of customers in the US, Canada and the United Kingdom. For employees of the Arbitron Company, the media research business of Ceridian, honing a particular analytical or technical skill is not enough to convince a cable company in England that you understand their advertising needs. Continuous learning that exposes employees to different cultures and new ideas, and fosters innovative thinking and problem-solving abilities, is the key to getting and retaining diverse customer business.

Sustained economic growth depends on workers being able to continuously upgrade their education and skill levels. That's why employers serious about maintaining a competitive edge are incorporating principles of lifelong learning into their corporate strategies and values. Employers have a direct interest in ensuring the besteducated workforce. Lifelong learning ensures not only a high-skilled technical workforce, but also better educated workers able to meet the competitive challenges

of a borderless world.

Mr. Chairman, despite the necessity of higher education and training, workers often lack access to educational opportunities. As part of Ceridian's commitment to lifelong learning, section 127 has been an effective tool to breaking down cost barriers and creating new opportunities to pursue education that may not be directly job-related. At Ceridian Employer Services (CES), our payroll and human resource business, 10 percent of the domestic workforce currently receives tuition assistance and \$370,000 in aid was provided to employees last year. Although most companies' tuition assistance policies do not provide 100 percent of the total tuition cost, employer provided assistance through section 127 helps. The value of section 127 could be even greater if this important tuition assistance provision was applicable to graduate education and was made permanent law.

Many employees receiving aid are in entry-level, lower-paying jobs. They cannot afford to pay for additional education. One employee in California joined CES in an entry-level technical service position. After completing his college degree with the help of tuition assistance, he is today a District Vice President of client services. The average age of an undergraduate student also is increasing—more than one-fourth of all undergraduates are over thirty years old, many with families to support. A former secretary and single mother of two children in Ceridian's corporate tax department received a degree with tuition assistance and advanced her position within the tax department. She is now a tax accountant and is going on 20 years with Ceridian. Tuition assistance often is the only way people can afford to upgrade their education level while certificities and continuing to work and current their families.

their education level while continuing to work and support their families.

The stories of our DVP of client services and our corporate secretary illustrate another benefit of section 127—it allows employees to exclude from their taxable income tuition assistance they receive for education that may not be specifically jobrelated. A misconception about tuition assistance is that in order for the aid to be of value, the education must upgrade a specific skill set Section 127 allowed the tax secretary to pursue a degree that might not have been considered directly related to her job as a secretary. Also, liberal arts degree programs—which are not likely to be directly job related in general—expand the knowledge base and prepare individuals to think and work more creatively

Mr. Chairman, Federal Reserve Board Chairman Alan Greenspan remarked several weeks ago at the American Council on Education that, "our institutions of higher learning now bear the overwhelming responsibility for ensuring that our society is prepared for the demands of rapid economic change." At Ceridian and many other companies throughout the US, a broad education is increasingly necessary to main-

tain competitive advantage.

Ceridian's growth depends on our ability to develop and deliver leading-edge products and services and provide best-in-class customer service. Employees who are able to interact with different types of people in diverse industries are most effective. When a CES employee is better able to understand customer needs and market

requirements, Ceridian and our employees both stand to gain.

Lifelong learning today does not stop with an undergraduate degree. To encourage employees to pursue educational opportunities, Ceridian provides tuition assistance for a broad range of degree programs, including graduate-level education. Graduate education further expands workers' grasp of theories and perspectives that underpin the next waves of innovation. In information services, Ceridian's competitiveness depends on the creativity of our employees and the added value we provide customers. If employees at Ceridian's Comdata transportation services business can't find new ways to help long-haul trucking companies manage costs, Comdata loses market share. And if we can't discover more efficient ways of helping employers manage tax and workplace compliance, CES customers will go elsewhere.

Ceridian has successfully built lifelong learning into our employee education and training programs, and believes that the education level an employee pursues should not be limited by the tax treatment of that education. One employee with a sales background, who wants to transition into marketing, has been pursuing a a sales background, who wants to transition into indirecting, has been pursuing a graduate business degree with tuition assistance. Another employee studied for her doctorate in organizational development with CES' assistance, and already has started to reap the benefits—for her and for CES. Her studies and improved skills set have enabled her to complete critical analytical work that otherwise would have been outsourced. Undergraduate and graduate studies are equally important to Ceridian and its employees. Undergraduate and graduate educational assistance should receive equal tax treatment.

Finally, section 127 should be made permanent law. It can be an effective recruitment and retention tool providing employees access to a broad spectrum of educational opportunities that many could not pursue on their own. The CES employee

pursuing a graduate business degree has been with the company for over 10 years, and the former corporate tax department secretary, now tax accountant, has been with Ceridian for 20 years. Employees appreciate the access to education and self-development provided by Ceridian. But the uncertainty of section 127 hinders employees' ability to prepare in advance their course of study. That can limit the benefit of tuition assistance and curtail the studies of employees, particularly those with

cost concerns or pursuing graduate degrees.

The on-again, off-again status of section 127 also has only added unnecessary tax complexity for employers and employees. One of the goals of section 127 when it was enacted in 1978 was to reduce tax code complexity. But switching tuition aid from taxable to non-taxable retroactively causes a tremendous amount of administrative rework for payroll. Employers are forced to identify all employees who had taxable tuition aid, and determine if that aid now qualifies for non-taxable status. If it does, amended tax forms and new W-2C's must be created for those individuals. Employees also are forced to amend their tax returns if they have already filed. At CES, given their volume of tuition aid, this can take 2 to 3 employees up to 2 weeks to complete.

In closing, Mr. Chairman and members of the Committee, I would return to the beginning of my statement and urge Congress and the Administration to view Section 127 as an investment in 21st century education and skills. I believe that the new century will witness a revolution in education—specifically in innovative partnerships between employers and schools, K-12, community colleges and universities. These partnerships will help create what some call the virtual university—and they will exist primarily to educate and train employees for 21st century jobs in the glob-

al, networked, information economy.

Congress needs to do everything possible to support the trend toward educational partnerships for lifelong learning. Section 127 is one critical piece among many public policy initiatives to promote education and training. Section 127 helps employees learn; it helps companies be more productive; it helps America be more competitive. It will help ensure that US workers are able to compete for the jobs of the future.

Prepared Statement of William E. Manning

Bill Manning has been President of the Red Clay Consolidated School District Board of Education (Delaware's second largest school district) for nine years. An attorney by trade, Mr. Manning has been among Delaware's leaders in proposing and implementing a variety of educational reforms: public school choice, charter school legislation and rigorous academic standards statewide. Red Clay is currently the only district in Delaware to have reached an agreement with its teachers association pursuant to which Red Clay teachers will be evaluated based on student performance. Among other recognitions, Mr. Manning was honored, in October, 1998, as one of the nation's "unsung heroes" in education reform by the Center for Education Reform in Washington, DC.

Demographically, Red Clay is a composite of all cross sections of Delaware and

America. It has both affluent areas and poverty stricken areas; suburban and city. Red Clay students speak a variety of native languages, including a large component

of Spanish-speaking children.

Red Clay's capital assets are probably typical of those found throughout America. No new schools have been built for more than 30 years and existing schools require repair and renovation. After one unsuccessful attempt, Red Clay received referendum approval both to make the most needed repairs to its buildings and invest in technology. That capital program, however, is much smaller than Red Clay would prefer, and new schools and renovations remain critical.

STATEMENT REGARDING THE FEDERAL ROLE IN SCHOOL CONSTRUCTION

I don't want to begin my testimony by assuming that the federal government should have any role at all in public education. Indeed, many of those in the education reform community believe that the federal government should diminish, rather than increase, its role in public education. Let me give you one good reason why that is so. With all of the talk regarding education reform these days, one particular notion is being identified as having preeminent importance: "accountability." Indeed, it is acquiring buzzword status. Presidents, members of Congress, governors and school board members all over the country are talking about the importance of accountability and they are all correct. However, to the extent that you shift the locus of decision making from the school to the district to the state to the federal level, the more you have diminished the chances that those responsible for delivering educational services can be held accountable for their successes or failures. Put another way, if I am a school administrator and I can point to burdensome and inappropriate federal regulations as the reason for my failure to provide adequate facilities, I will.

All of that leads me to bring two messages today: (1) Don't do anything at all and, if you have loose change rattling around in the federal coffers, send it back to those who gave it to you in the first place. (2) If you must do something, make good on all the promises of local autonomy and flexibility that inevitably accompany all such programs. Don't let the public educational establishment claim that: "But for this federal regulation or that federal guideline, we could have done the job."

If you detect a note of cynicism about federal promises for local autonomy and flexibility, you are correct. That cynicism, however, is justified as we out in the states hear more and more about some of the proposals before you. For example, 1 understand that the President's proposal wants to encourage capital apending by

I understand that the President's proposal wants to encourage capital spending by school districts that would not have been possible without such financial assistance. Therefore, as a criterion for eligibility, one would not be surprised to see the Department of Education require an applicant to make some sort of showing that its proposed capital expenditure would not otherwise happen.

One imagines several responses to such a rule. First, the "green eyeshade guys" that exist within each school district will now slow down some projects, testing the political waters each day to see whether increased federal funding is soon to be available. After all, to move forward with capital projects at this time may be to render them ineligible at a later time. Thus, the games begin. Second, what is so wrong with providing assistance to a district that has already decided to "bite the bullet" and ignore other priorities in order to make capital repairs? It seems to me that this particular element of the President's proposal removes, rather than creates, incentive for local responsibility.

To take another example, one who reading about the President's current proposal comes away with the sense that there will be significant means-testing within the eligibility criteria. I certainly hope, on behalf of my school district, that I will be able to use whatever capital assistance the federal government decides to give me anywhere in my district-whether it be in downtown Wilmington or out in the sub-

urbs.

Please understand that any federal rules and regulations accompanying any new federal financial assistance will apply on top of a host of other regulations already imposed at the state level. Indeed, as I indicated, this hotchpot of regulations imposed upon local school districts at the state level already gives the establishment enough places to hide from true accountability as it is. It is almost inconceivable that a new regime of federal requirements would not be, in some ways, inconsistent with a body of regulations that, in my view, is already too large. Thus, the prospect of time wasted and projects left undone because of conflicts between federal and state regulation grows with every new federal program. Please make any program that results from the proposals before you serve as a testament that the federal government can, if it wants to, render meaningful assistance without creating matching unnecessary burdens.

Let me close with a few specific suggestions. First, I believe, as do many of you, that charter schools are already improving the educational landscape by offering variety, quality and single-school focus to those who previously had to pay to get those things. That's the good news. The bad news is that charter schools are still regarded by the educational establishment in some quarters as the enemy. Thus, the organization that owns our school buildings is sometimes stingy with them when it comes to housing charter schools. Nor do the funding formulae in many state charter school bills provide adequate capital—as opposed to operating—assistance to charter schools. In that environment, it would be particularly fitting if the federal government took special care to ensure that our new charter schools were well housed.

Please don't overlook them.

As you review the variety of proposals before you, I suggest that you carefully review those that would render assistance to local school districts needing capital assistance and simultaneously reduce federal "red tape." In Delaware, for example, we have several lending institutions that are members of the Federal Home Loan Bank—one of the Nation's few triple A rated institutions. If these lenders could offer the Federal Home Loan Bank's credit to support bond-financed school construction projects, then the cost of debt-even tax exempt debt-would go down. However, for reasons that appear only to have historical significance, Federal Home Loan Banks are not permitted, under Section 149 of the Internal Revenue Code, to provide such credit enhancement. Nor does it appear that those federal (and former federal) instrumentalities that are so authorized by Section 149 (Federal Housing Administration, Veteran's Administration, Fannie Mae, Freddie Mac, Ginnie Mae and Sallie Mae) are actually in the business of assisting school financing. Thus, Section 149 of the Internal Revenue Code should be amended to permit Federal Home Loan Banks to sell credit enhancement products—at least in the area of school construc-

tion finance if not all projects eligible for tax exempt financing.

I appreciate the opportunity to share my thoughts with the Committee. I realize that my plea to send those tax revenues that might otherwise have been spent by the federal government back to the taxpayers requires that Congress ignore the political head of steam building over this issue. So, if the federal government decides it wants or needs to play a role in building schools, please do it in a way that leaves school board members like me, as well as the administrators and teachers who we employ, exposed to the consequences of our failure, if that be the case, to do our job and deliver a quality education to each of our students.

PREPARED STATEMENT OF HON. MITCH McCONNELL

Mr. Chairman, I am pleased to have this opportunity to come here today to discuss legislation, which I introduced, along with my colleague, Senator Graham, that addresses an important issue facing American families today—the education of their children. It is my long-held belief that we need to make a college education more affordable, and the legislation I have introduced, S. 387, the College Savings Act,

will do just that by providing tax incentives to families who save for college.

Mr. Chairman, I have not been alone in my efforts to give parents more flexibility to choose the school which is best for their children and to make those decisions more affordable. As I have already mentioned, my colleague from Florida, Senator Graham, has been my partner in sponsoring this legislation since we first introduced it in 1994. 1 appreciate his leadership and support. I also want to recognize my esteemed colleague from Georgia, Senator Coverdell, who has championed the cause by introducing legislation which would increase the amount families can save for elementary and secondary education in an education IRA. Finally, I would like to commend the distinguished Chairman of the Finance Committee, Senator Roth, who has worked tirelessly to help all Americans save for their retirement. I want to thank the Chairman for his support of these education savings initiatives, especially his support of the state-sponsored savings and prepaid programs.

Mr. Chairman, the legislation I have introduced is a serious effort to reward longterm saving by making savings for education tax-free. It is important that we not forget that compounded interest cuts both ways. By saving, participants can keep pace, or even ahead of, tuition increases while putting a little away at a time. By borrowing, students bear added interest costs that add thousands to the total cost of tuition. Savings will have a positive impact, by reducing the need for students to borrow tens of thousands of dollars in student loans. This will help make need-

based grants, which target low-income families, go much further.

Anyone with a child in college knows first-hand the expense of higher education. Throughout the 1990's, education costs have continually outstripped the gains in income. Tuition rates have now become the greatest obstacle students face in attending college. In fact, the astronomical increase in college costs has been well documented. According to a study conducted by the College Board, tuition and fees for a four-year public university rose 107 percent from 1980-1997, while median house-

hold income rose only 12 percent.

Due to the high cost of education, more and more families have come to rely on financial aid to meet tuition costs. In fact, a majority of all college students utilize some amount of financial assistance. In 1997-98, \$60 billion in financial aid was available to students and their families from federal, state, and institutional sources. This was \$3 billion higher than the previous year. A majority of this increase in aid was in the form of loans, which now make up the largest portion of the total federal-aid package at 57 percent. Grants, which a decade ago made up 49 percent of assistance, have been reduced to 42 percent. This shift toward loans further burdens students and families with additional interest costs.

Mr. Chairman, we must reverse the dependence on federal assistance and encourage families to save. My legislation would reward savings and allow students and families that are participating in these state-sponsored plans to be exempt from federal income tax when the funds are used for qualified educational purposes. This legislation also recognizes the leadership that states have provided in helping families save for college. In the mid-1980s, states identified the difficulty families had in keeping pace with the rising cost of education. States like Kentucky, Florida, Ohio, and Michigan were the first to start programs in order to help families save for college. Nationwide more than 30 states have established savings programs, and over a dozen states are preparing to implement plans in the near future. Today, there are nearly one million savers who have contributed over \$3 billion in education savings. The provision which I authored, which allows tax-free education savings in state-sponsored savings plans for education purposes, provides nearly a \$1.5 billion tax break for middle-class savers nationwide. In Kentucky, over 3,720 families have established accounts, which amount to about \$7.5 million in savings.

I have worked closely with the state plan administrators over the years seeking both their advice and support. Again this year, I am pleased to have the National Association of State Treasurers and the College Savings Plans Network endorse this legislation. They have worked tirelessly in support of this legislation because they know it is in the best interest of plan participants—the families who care about their children's education.

Mr. Chairman, I have a letter endorsing my legislation from the National Association of State Treasurers which I added at the end of my testimony, along with a state-plan chart from the College Savings Plan Network that categorizes the state tuition savings programs, which I think will give the Committee a clear understand-

ing of the state plans that exist.

Mr. Chairman, many Kentuckians are drawn to this program because it offers a low-cost, disciplined approach to savings. In fact, the average monthly contribution in Kentucky is just \$52. It is also important to note that 60 percent of the participants earn under \$60,000 per year. By exempting all interest earnings from state taxes, my legislation rewards parents who are serious about their children's future and who are committed over the long-term to the education of their children by providing a significant tax break for middle-class savers nationwide. Clearly, this benefits middle-class families.

In 1994, I introduced the first bill to make education savings exempt from taxation. Since then I have won a couple of battles, but still haven't won the war. To win the war, Congress needs to make education savings tax free—from start to fin-

ish. The College Savings bill, S. 387, will achieve that goal.

In 1996, Mr. Chairman, thanks to your leadership, Congress took the first step in providing tax relief to families investing in these programs. In the Small Business Job Protection Act of 1996, 1 was able to include a provision that clarified the tax treatment of state-sponsored savings plans and the participants' investment. This measure put an end to the tax uncertainty that has hampered the effectiveness of these state-sponsored programs and helped families who are trying to save for their children's' education. Also in 1996, Virginia started its plan and was overwhelmed by the positive response. In its first year, the plan sold 16,111 contracts raising \$260 million. This success exceeded all goals for this program.

In 1997, again with the support of the Chairman, revisions were made in the Tax-payer Relief Act to provide maximized flexibility to families saving for their children's college education. The most significant reform was to expand the definition of "qualified education costs" to include room and board, thus doubling the amount families could save tax-free. In Kentucky, room and board at a public institution make up half of all college costs. This important legislation also expanded the definition of eligible institutions to include all schools, including certain proprietary schools, and defined the term "member of family" to allow rollover eligibility for cousins and step-siblings in the event that the original beneficiary does not attend college.

Last year, the Senate passed legislation, sponsored by Senator Coverdell and Senator Torricelli, which would have allowed parents to place as much as \$2,000 per year, per child, in an education savings account for kindergarten through high school education. Included in this legislation was my proposal to make savings in state-sponsored tuition plans tax-free. Unfortunately, the bill was vetoed by Presi-

dent Clinton.

As a result of our actions over the last several years, more and more state plans have implemented tuition savings and prepaid plans for their residents. It is projected that there will be 43 states with tuition savings plans by the year 2000. 1 believe that we have a real opportunity to go even further toward making college affordable to American families. It is in our best interest as a nation to maintain a quality and affordable education system for everyone. By passing this legislation, we can help families help themselves by rewarding savings. This will reduce the cost of education and will not unnecessarily burden future generations with thousands of dollars in loans.

I urge the Committee to support this valuable legislation this year to reward

those who save in order to provide a college education for their children.

Thank you, Mr. Chairman.

College Savings Plans Network

February 4, 1999

The Honorable Mitch McConnell United States Senate Room 361A Russell Senate Office Building Washington, D.C. 20510

RE: College Savings Legislation

Dear Senator McConnell:

On behalf of the College Savings Plans Network ("CSPN"), which represents the 44 states currently offering and managing college savings programs, I am writing to express our strong support for your legislation to provide tax-free treatment for contributions to the qualified state tuition programs. CSPN applands your leadership on legislation to encourage saving for college. Currently, there are over \$49,288 signed college tuition contracts. The estimated fair market value of these contracts is over \$4.2 billion. The families participating in the programs appreciate your efforts on their behalf.

The College Savings Plans Network embraces and fully supports the intent of the College Savings Act of 1999. The public policy intent of this proposal is to enable and motivate families to save for college by providing clear and easily understood tax treatment of the qualified state tuition plans.

CSPN greatly appreciates and fully supports the legislation and your leadership on this proposal.

Sincerely.

Marshall Bennett

Chairman, College Savings Plans Network, and

Mississippi State Treasurer

01/14/99 5:12 PM COLLEGE SAVINGS PLANS NETWORK State College Savings Plans Overview

State	Name of Program	Operational	Program Type	Talanhama
Alabeme	Prepaid Affordable College Tuition	✓ 1990	Prepaid Tuition	Telephane 1-800-252-7228
Alaska	Advance College Tuition Payment Program	√ 1991	Prepaid Tuition	
Arizona	Family College Savings Program	✓ Aug98	Savings Plan	1-800-478-0003 (*) 1-602-229-2592
Arkansas	studying feasibility		on in Par 1401	1-002-229-2592
California	Golden State Scholarshare Trust	Spring-99	Savings Plan	1-916-526-3027
Colorado	Colorado Prepaid Tuition Fund	✓Sept. 97	Prepaid Taition	1-800-478-5651
Connecticut	Connecticut Higher Education Trust	✔Dec97	Savings Plan	1-888-799-2438
Delaware	Delaware College Investment Plan	€ July-1998	Savings Plan	J-800-292-7935
Florida	Florida Prepaid College Program	✓ 1988	Prepaid Tuition	1-800-552-4723
Georgia	HOPE Scholarship		Scholarship	1-800-776-6878:
Hawaii	studying feasibility			1-00-770-0678
Idaho	Legislation filed, but not enacted.		,	`
Dinois	College Illinois	√ Oct. 98	Prepaid Tuition	1-877-877-3724
Indiana	Family College Savings Program	✓ 1997	Savines Plan	1-888-814-6800
lowa .	College Savings Iowa	✓Sept. 1998	Savings Plan	1-888-446-6696
Kansas	studying feasibility			1-000-1-10-0050
Kentucky	Educational Savings Plan Trust	✓ 1990	Savings Plan	1-800-338-0318
Louisiana	Louisiana START	✓July-97	Savings Plan	
Maine	Maine College Savings Program	1998/99	TRD	1-800-259-5626, ext. 0523 1-207-623-3263
Maryland	Maryland Prepaid College Trust	✓Apr1998	Prepaid Tultion	1-888-463-4723
Massachuseus	U-Plan	√ 1995	Prepaid Tuition	
Vichigan	Michigan Education Trust	✓ 1988	Prepaid Tuition	1-800-449-6332 1-800-638-4543
Minnesota	Minnesota EDVEST	1999	Savings Plan	
Mississippi	Prepaid Affordable College Tuition	√ 1997	Prepaid Tuition	1-800-657-3866, ext. 3377 1-800-987-4450
Missouri	Family Higher Education Savings Plan	Feb-99	Savings Plan	1-573-751-2411
Montana	Family Education Savings Program	√ 1998	Savings Plan	1-800-888-2723
Nebraska	studying feasibility	,,,	ALANES L'AM	1-0W-055-2/25
Vevada	Prepaid College Tuition Plan Trust Fund	√ Oct-98	Prepaid Tuition	J-888-477-2667
New Hampshire			Savines Plan	1-603-271-2621
New Jersey			Savings Plan	1-877-465-2378

New Mexico	Name Pending	Spring-99	Savings Plan	1-505-827-7383
New Yark	College Choice Tuition Savings Program	✓ Sept1998	Savings Plan	1-877-697-2837
N. Carolina	Callege Vision Fund	✓ Jupe-1998	Savings Plan	1-800-600-3453
N. Dakota	No program			
Otnio	Ohio Prepaid Tuition Program	✓ 3989	Prepaid Toition	1-800-233-6734
Oklahoma	Oklahoma College Savings Plan	1999	Savings	1-405-521-3191
Oregon	Studying Feasibility			1-503-378-4329
Pennsylvania	Tuition Account Program	✓ 1993	Prepaid Taition	1-800-440-4000
Rhode Island	R.I. Higher Education Savings Trust	✓ Sept. 24, 98	Savings Plan	1-877-474-4378
S. Carolina	SC Tuition Prepayment Program	✓ Sept. 98	Prepaid Tuition	1-888-772-4723
South Dakota	No program			•
Tennessee	Tennessee BEST	√ 1997	Prepaid Tuition	J- 888-48 6-2378
Texas	Texas Tomorrow Fund	√ 1996	Prepaid Tuition	1-800-445-4723
Utah	Educational Savings Plan Trust	√ 1996	Savings Plan	1-800-418-2551
Vermont	Vt. Higher Education Savings Plan	Early-1999	Savings Plan	1-800-642-3177
Virginia	Prepaid Education Program	√ 1996	Prepaid Taution	1-888-567-0540
Washington	Gnaranteed Education Tuition Program	✓ Summer-98	Prepaid Tuition	1-877-438-8848
West Virginia	WV Prepaid College Plan	✓Oct. 98	Prepaid Tuition	1-800-307-4701
Wisconsin	EDVEST Wisconsin	✔ 1997	Savings	1-888-338-3789
Wyoming	Advanced Payment for Higher			
,	Education Cost	✔ 1987-95	Prepaid Tuition (a)	1-307-766-5766
Dist. of Columbia	National Capitol College Savings Trust	1999	Savings Plan	1-202-727-6055

KEY:

TBD - To be determined

(*) - Toll free available for in-state calls only.

✓ - Program operational

NOTES:

(a)Program suspended in 1995 because of non-participation, but counted as active because it is honoring previous contracts. Studying feasibility of a savings plan program.

SOURCE: The College Savings Plans Network of the National Association of State Treasurers.

"THE NUMBERS"

Current Prepaid

19 (Alabama, Alaska, Colorado, Florida, Illimois, Maryland, Massachusetts, Michigan, Missassippi, Nevada, Ohio, Pennsylvania, South Carolina, Termessoe, Texas, Virginia, Washington, West Virginia, Wyomung)

Note: Wyoming program suspended.

Current Savings

15 (Arizona, Commecticut, Delaware, Indiana, Iowa, Kentucky, Louisiana, Montana, New Hampahire, New Jersey. New York, North Carolina, Utah Rhode Island, Wisconsin)

Savings To Be Operational

9 (California, District of Columbia, Maine, Massachusetts, Minnesota, Missouri, New Mexico, Oklahoma, Vermont)
Note: Massachusetts has a sovings plan pending for college expenses. Also, Wyoming studying savings plan optim.

Long Range Total: Prepaid=19 Savings=24 Total = 43 + Georgia HOPE = 44

For more information, visit the CSPN web site at http://www.collegesavings.org

PREPARED STATEMENT OF JIM McCarthy

Good morning, Mr. Chairman and Members of the Committee. I am Jim McCarthy, Vice President and Business Development Manager, Private Client Group, for Merrill Lynch & Co., Inc. Thank you for giving me the opportunity to discuss our experience with the Education IRA, qualified state tuition programs (QSTPs) and

other programs to assist with college savings.

Let me congratulate the members of this Committee for creating the Education IRA. American families confronting college education costs for one child face a formidable task. For families with two, three or more children, college education costs can be overwhelming. The Education IRA, for the first time, provides families with meaningful help in starting to save for college education.

We believe that the general Education IRA structure provides a strong framework for an effective savings program. We suggest, however, that the following changes must be made if the Education IRA is to fulfill its potential:

 The \$500 annual Education IRA contribution limit should be increased to at least \$2,000.

An annual catch-up contribution of \$2,000 for those children who are approach-

ing college age should be allowed.

The complex Education IRA income eligibility rules should be eliminated.

 Education IRA withdrawals that are actually used to cover college expenses should not lose tax-favored treatment simply because the family is entitled to a HOPE credit or Lifetime Learning credit with respect to other college expenses.

We also support improvements in the rules governing QSTPs, but strongly urge the Committee not to add additional restrictions or limits to the existing rules.

BACKGROUND

The high cost of getting a college degree is well documented. Since the early 1980s, the cost of college has increased at a significantly faster pace than inflation. According to the U.S. Department of Education, between 1985 and 1995, tuition, room, and board at public institutions increased from 11 percent to 15 percent of me-

dian family income.[1]

Today, most families fund college education through a combination of "pay-as-yougo" financing and "pay-after-you-go" student loans. Over the last two decades, as college tuition and other education costs have continued to rise, direct financial aid has diminished. As a result, it has become more and more difficult for families to cover college expenses as they are incurred. That, in turn, has meant that student and parent loans have been used to finance an increasing share of higher education costs. For many, the price of a college education now involves having to deal with an overwhelming repayment burden for many years after graduation. All too often, loan defaults and demoralizing bankruptcy proceedings can result.

Federal government programs and policies have historically been designed to help people deal with the burdens of college through assistance with these pay-as-yougo and pay-after-you-go methods of financing. Over the years, Federal assistance has taken many forms, ranging from grants and other financial aid, tax credits, subsidized higher education loans and tax advantages for student loans (such as the ability to deduct student loan interest). For those who have wanted to save for college in advance, there has been little incentive and, considerable confusion as to how or whether saving in advance made sense. By focusing Federal efforts primarily on assisting with pay-as-you-go financing and subsidized loans, the Federal govern-

ment sent a strong signal that advance funding of college was not very important. Now, Mr. Chairman, I am not saying that subsidized loans (and other federal programs) to help pay for college education are bad. Just the opposite, student loans have helped many millions of Americans attend college. I certainly do not know how I would have made it through college and post-graduate education without the availability of loans. Most families with children in college will continue to need all available resources-including grants, student jobs, loans, tax credits, and personal sav-

Yet, reliance on pay-as-you-go incentives and loans can be risky. To begin with, there is no guarantee that those sources will be available in sufficient amounts when a child reaches college age. Moreover, excessive loans are not an optimal method of financing college education. As I noted, loans can place a heavy burden

on the family and the student for many years after graduation.

The way to finance college education with the least disruption for families, and the smallest financial burden after college graduation, is to save as much as possible for college in advance. By saving before a child reaches college age, families can help ensure that adequate funds will be there to allow their children to attend college. Moreover, by beginning an education savings strategy for a child at an early age, the family further reduces its overall burden through the so-called "miracle of

compounding.

Despite those and other advantages, there was no meaningful Federal program designed to help families save for college until this Committee helped establish the Education IRA starting last year. Education IRA The Education IRA has given America's families a critical new tool to help them get ready for college. The simple message of the Education IRA is that saving in advance for a child's higher education costs must be a high priority. In giving a tax advantage for college savings, the Federal government has sent out a highly visible signal to American families that they had better take seriously the need to plan for their children's higher edu-

To date, there is no industry-wide data on utilization of the Education IRA. Merrill Lynch's experience has been that the public response to the Education IRA has been very positive. On the whole, most people find a Federal tax program, with relatively clear (albeit complex) tax treatment, far preferable to the state law trusts

for minors that have historically been the main way to save for college.

Our network of financial consultants reports that questions about the Education IRA have been near the top of the list of issues that clients wish to discuss.

One interesting aspect of the Education IRA that is often overlooked is the fact that it is a savings vehicle for the extended family. We have found that contributions do not only come from parents. They cor e from grandparents, aunts, uncles, godparents and others who want to contribute to a loved one's future education. Often the grandparent may be uncomfortable giving money to the children, perhaps because they are concerned that they may be interfering. Yet those same grand-parents are comfortable setting up an Education IRA for each of their grandchildren. In providing a mechanism that allows these extended-family members to contribute to a child's higher education costs, the Education IRA has opened up new avenues for college savings.

IMPROVING THE EDUCATION IRA

Despite the initial favorable response to the Education IRA, there are a number of changes in design that must be made if the Education IRA is to have a meaningful impact on the ability of American families to prepare for college education expenses. These changes fall into two main categories—(1) increasing the amount that

can be contributed and (2) the need to simplify the rules.

Increasing the \$500 Contribution Limit—The current \$500 maximum contribution to an Education IRA is weefully inadequate. For a child born today, if the maximum \$500 contribution was made to the child's Education IRA in each year, that child would only have about \$17,000 by the time he or she reached college age in 2016[2]—an amount that could be little more than is needed to fund one semester's

tuition, room and board at an in-state public institution.[3]

The \$500 contribution limit also creates many other problems that severely limit the effectiveness of the Education IRA. First, during the early years of an Education IRA, the account balance is so small that fees associated with administering the account could exceed any earnings. For example, if a financial institution charges only \$40 annually to administer an Education IRA, the assets in the account would have to earn almost a nine percent rate of return, just to break even during the first year the account is in existence. People understand this, and many are reluctant to begin savings through a vehicle that could lose them money during the early years

Equally important, the small account size that flows from the current \$500 contribution limit has meant that many financial institutions do not even offer Education IRAs to their customers. For those institutions that have incurred the expense of offering Education IRAs, advertising has been minimal. To prove that point, one need do no more than compare the advertising of Roth IRAs to the advertising of the Education IRA over the last year. If we are to get American families focused on the importance of saving for college early, we need to recreate and expand the type of saturation advertising that made IRAs for retirement so successful a decade ago.

Here it is important to remember that before the Education IRA can be an effective vehicle to get families to start saving more for college, those families must first be educated on the importance of engaging in that savings behavior. Most Americans understand that college is expensive, but few realize just how expensive. For 40-year-old parents with two children age 11 and 9, the present value of the cost

of sending their children to college rivals the cost of saving for retirement.

American families need to be made more aware of the scope of the financial crunch that comes when children begin college. Advertising of Education IRAs would be an effective instrument for educating the American people about the importance of college saving. That advertising will not occur as long as the maximum Education IRA contribution is \$500.

At a minimum, the maximum annual Education IRA contribution should be increased to \$2,000. At that level, significant advertising could be expected and many of the small account problems would be eliminated for most contributors. Equally important, a \$2,000 annual contribution could, if the savings begins early enough in the child's life, make a meaningful contribution towards the total cost of a college education.

The members of this Committee may also wish to consider those who are already approaching college age. For a family with a child aged fourteen, even \$2,000 per year would only fund a small portion of the cost of attending college. Yet that family did not have an Education IRA or similar college savings vehicle available to them until last year. Mr. Chairman, in the retirement area you have suggested that it makes sense to give people a chance to "catch-up" in their retirement savings as they approach retirement. A similar catch-up concept would make a great deal of sense for that family with the fourteen-year-old. The simplest approach could be to allow an additional \$2,000 annual Education IRA for those over a specified age for example age twelve.

Simplifying the Education IRA—If the Education IRA is to be successful, it must also be simplified. Complex restrictions on eligibility and "fine print" on the availability of favorable tax treatment confuse people and scare them away from contrib-

uting. It is always easier to spend more on a vacation or a bigger car, than it is to put your money into something that you do not really understand.

Today, eligibility to contribute to an Education IRA for a child is limited depending on the contributor's modified adjusted gross income. Our experience with traditional IRAs, Roth IRAs and Education IRAs shows that limiting access based on income ends up reducing savings at all income levels. Right about the time someone starts getting interested in setting up a new IRA or Education IRA, they hear a discharge that and a setting up a new IRA or Education IRA, they hear a discharge that and a setting up a new IRA or Education IRA, they hear a discharge that and a setting up a new IRA or Education IRA, they hear a discharge that a set in the setting up a new IRA or Education IRA, they hear a discharge that a set in the setting up a new IRA or Education IRA, they hear a discharge that a set in the set in the setting up a new IRA or Education IRA, they hear a discharge that a set in the set in claimer that only certain individuals are eligible and that they should immediately check with their tax advisor to see if they qualify. That scares people, especially the middle income families who do not have a tax advisor. They automatically assume that they are one of the ones that are excluded. Or they decide not to start the pattern saving because they assume they won't be eligible next year and that it is just not worth the trouble.

The experience with the income limits that were placed on traditional IRAs in 1986 is illustrative of this point. Although the intention may have been to take the IRA away from more affluent households, the end result of the 1986 Act income limits was to drive over seven million Americans with income below \$50,000 out of IRAs. In fact, IRA contributions dropped by more than 40% for those who continued

before the changes that went into effect last year, IRA participation among those with income under \$50,000 had dropped by over 65%.

The lesson of the IRA experience is clear. Income limits confuse potential contributors and, in the end, drive away people who are eligible. For that reason, we strongly encourage the Committee to eliminate the complex Education IRA income

eligibility rules.

Similarly, uncertainty regarding the tax treatment of distributions has a chilling effect on contributions. This chilling effect is not always completely rational, but it is very real. Under the rules currently in effect, amounts distributed from Education IRAs are excludable from gross income to the extent that the amounts do not exceed qualified higher education expenses during the year of the distribution. That is a fair and easy to understand rule—if you use the money for college costs, you do not

pay tax.

The problems with the current distribution rules arise in the interaction of the if the HOPE or Lifetime Learning credit is claimed with respect to a beneficiary for the HOPE or Lifetime Learning credit is claimed with respect to a beneficiary for the year in which the Education IRA withdrawal is made, then the Education IRA loses its tax-advantaged treatment. This is true even if the family is entitled to a HOPE credit or Lifetime Learning credit with respect to some college expenses and the student is making the Education IRA withdrawal to pay other expenses.

Although some type of rule to prevent "double dipping"—claiming the HOPE or Lifetime Learning credit for the same expenses that are paid out of the Education IRA withdrawal to pay other expenses.

IRA-makes sense, the current rule is a clear case of overkill. For the Education IRA to be successful, individual's making contributions need to know with considerable certainty that they will get the tax benefit if they use the account to cover college costs. As a result, we recommend that the current rule denying all tax advantage to Education IRA withdrawals in any year in which HOPE or Lifetime Learning credits are claimed should be replaced with a narrower rule targeted to double

dipping.

A similar, problem arises with the severe restriction on Education IRA withdrawals if the individual does not withdraw funds to go to college. Today, an individual must withdraw all Education IRA balances within 30 days after attaining the age of 30 and the earnings portion of such distribution is fully taxable and subject to a 10 percent penalty tax because the amount was not used for education.

To understand the uncertainty that this age 30 rule creates, you can put yourself into the shoes of a grandparent wanting to contribute to an Education IRA of a young grandchild. That grandparent may hope (or even expect) that the grandchild will go to college, but they have no way of being absolutely certain. In many cases, that uncertainty can be enough to cause the grandparent not to make the Education IRA contribution. If on the other hand, the grandparent knew that if the child did not use the funds for college they could be transferred to a Roth IRA as the start of a retirement nest egg, the chances are increased that the grandparent would make the contribution. This is the approach that the Finance Committee followed in earlier versions of the Education IRA legislation. Of course, the vast majority of the children will end up using the money for college as originally intended, but the added flexibility will provide the needed comfort to the individual making the contribution in the first place.

QUALIFIED STATE TUITION PROGRAMS (QSTPS)

Section 529 of the Internal Revenue Code (as modified in the Taxpayer Relief Act of 1997) includes rules which provide incentives to save through QSTPs. For many, these state-run programs can provide considerable benefit. At this time, we do not have a great deal of data about QSTPs. Although some states have had programs in effect for a number of years, most are still adjusting their programs to deal with the changes enacted in 1997.

Even with higher annual contribution limits on Education IRAs, many families will not be able to save adequately through that vehicle exclusively. For them, QSTPs can provide an additional avenue for college saving. For others, who perhaps have a family history of attending a particular state institution of higher learning, contributing to a QSTP can be a logical and responsible way of continuing that family tradition. Consequently, we encourage this Committee to consider changes to im-

prove the tax rules governing QSTPs.

QSTPs do not receive the same tax treatment as Education IRAs. Generally, distributions or educational benefits provided through a QSTP are taxable to the student to the extent they exceed contributions. Proposals have been made to provide distributions (or education benefits) provided through a QSTP tax treatment similar to that currently afforded Education IRAs. We urge the Committee to explore that approach, but strongly caution against placing additional restrictions on contributions to QSTPs as a part of that effort.

For example, any proposal to place a contribution limit on QSTP contributions should be rejected. Although such a cap might be adequate to finance higher education costs in one state, it would not necessarily be (or stay) at a sufficiently high level to finance education costs in another state, or for an out-of-state resident. In this regard, the Committee's should evaluate the interaction of any changes in the

rules governing QSTPs with the rules governing Education IRAs.

The rules today set up a logical savings progression for a family wanting to save for college. First, they would contribute to the Education IRA which provides considerable flexibility regarding the choice of educational institution and investment control and has the most favorable tax treatment. If the individual has additional amounts available for savings, then contributions to a QSTP may be in order. Although the tax treatment of QSTPs is not as generous, higher contributions are allowed. This provides a relatively simple decision matrix for the individual.

If the tax treatment of QSTPs is improved, then the decision matrix might become somewhat more complicated, but for the most part would remain unchanged, since the added flexibility of the Education IRA would, for most, lead to making contributions to that account first. If, however, the price tag for the improved tax treatment of QSTPs is a cap on the total that can be contributed, then the ability of individual's to set aside funds for college could actually have been substantially reduced. That result should be avoided. Efforts to improve incentives to save should not have the counterproductive result of reducing the incentives that are currently in place.

CONCLUSION

Mr. Chairman and Members of the Committee. Thank you for giving me the opportunity to testify today. The Education IRA that you created provides an excellent

framework for helping Americans better prepare for college. I urge you to carefully consider changes in that structure that will make it stronger and help millions of today's children earn a college education.

ENDNOTES

[1] National Center for Education Statistics, Digest of Education Statistics 1996.

[2] Assumes 7 percent annual rate of return on investment in the Education IRA.
[3] Assumes 7 percent annual increase in higher education tuition, room and board.

PREPARED STATEMENT OF ESTHELDA PARKER-SELBY

Good Morning: Senator Roth, Members of the Senate Finance Committee, Ladies and Gentlemen.

My name is Estrielda Perker-Selby. I am a native Delawarean who grew up and presently reside in Milton, Delaware. I am honored and pleased to have been asked to participate in today's session focused on education tax incentives.

As a single professional parent who is currently assisting my youngest son through college, I must admit that it has been a struggle making sure all educational and financial needs have been met. Due to many obstacles that have interrupted my life and career, I was unable to save a substantial amount of money for my children's college education. Therefore, our family is not loan free. Relatives have been helpful with funds for books and some spending change but the tuition cost have been my responsibility.

Historically, my family has attended schools in Delaware. I attended Delaware State University and the University of Delaware. My oldest son and now the youngest have also attended Delaware State University. Although the in state schools have a lower tuition fee allowed to in state students, the struggle has remained to pay the cost the best way possible. I have had to borrow college fees the entire tenure of my sons' college attendance. Fortunately, I have had a sufficient salary and credit history that has allowed me to borrow the necessary funds. I know of many people in Delaware who have not been able to meet the criteria to borrow and their children have had to wait a year and work for tuition fees or not attend college at all. I can think of a case close to me where a mother came to me seeking information on how she could get financial assistance to help her daughter return to school. Her daughter needed \$500.00. The point is that it is very difficult for many people to afford the cost to get their children educated and they need to know how to help themselves.

With the rising cost of a college education, citizens across the country will continue to face a need to get financial assistance. Therefore, I am sure I can speak for families regardless of their socio-economic needs when I say we need and want tax incentive plans that consider our varied needs.

I am a member of the Delaware Higher Education Commission and we recently introduced the Delaware College Investment Plan through Fidelity Investments. The plan is catching on and more are investigating the benefits and opting to try it. I have discussed the plan and concept with co-workers, friends and family and they have all agreed that people need to be able to start early to save for college and realyze some tax incentive benefits.

In my conversations, I kept hearing the words clearity, benefits, affordability, and accessibility. We all feel that education tax incentive plans are necessary and that all families should be able to benefit from them. We feel that whatever

plans are adopted, the explanation of the plans should be clearly defined and explain why and how they can benefit a family's future needs. Plans that are adopted must be affordable and accessible to all who are interested in participating.

There was discussion that any help through these plans that could decrease the tax burden on families would be greatly appreciated.

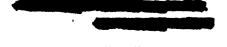
Overall, I am reminded of the wise words of Benjamin Franklin when he said, "If you empty your purse into your head, noone can take it away from you. An investment in knowledge always pays the best interest."

Thank You

Submitted By: Esthelda R. Parker-Selby March 1, 1999

Brief Biographical Sketch

Name: Esthelda Ramona Parker-Selby



Occupation: Principal of Rehoboth Elementary School

Rehoboth Beach, Delaware

Birth Place: Milford, DE

Education: Milton School 196-C (1-6)

William C. Jason Comprehensive High School (7-12)

College Prep. Diploma 1965

Delaware State University BA 1970

University of DE ME 1981

Memberships/ Honors

Teacher of Grades K-12

Part Time Adjunct Professor for DE State University
Member of De Higher Education Commission

Member of DE. Dept. Of Education's Teacher Recruitment

Task Force

Member DE. Dept. Of Education's Administrator Standards

Committee

Member of Numerous Education Committees at State and

Local Levels

Former Chairperson of the Sussex YMCA

Former Chairperson of the Rehoboth Art League Cottage

Tour

Chairperson of the William C. Jason High School Alumni

Association

Vice President of the Delaware State University National Alumni Association

Member of the Sussex County League of Women's Voters

Member Phi Delta Kappa, Delta Sigma Theta Sorority, Delta
Kappa Gamma Society and Links Inc.

Martin Luther King Community Service Award Delta Sigma Theta Outstanding Service Award YMCA Black Achiever Award

PREPARED STATEMENT OF HON. WILLIAM V. ROTH, JR.

Good morning. I want to welcome everyone here for the Finance Committee hear-

ing on education tax incentives.

As you can see from the witness list, we have a full slate this morning. We have five Senators who would like to testify, and then we have two panels of witnesses. In order to make sure that we have enough time to hear from all the witnesses and ask them appropriate questions, it is important for all of us to limit our opening comments. I am going to ask the Senators to keep their oral remarks to about three minutes. Full statements will appear in the hearing record.

That being the case, I will follow my rule and make just a few short comments. As we look around America today, we see few things that are as vital to our society as a quality education. And never has education been more important than now-a time when technology is so accessible, a time when potential is without limits, and a time when the advent of a global economy demands the best we have to

Yet, at the same time, all the data shows that education costs continue to rise at a rate higher than inflation. Families are finding it increasingly difficult to balance these high costs for education with all of their other financial obligations.

I believe that the federal government has a responsibility to promote policies and programs that will help American families to meet these burdensome-but necessary costs. During today's hearing we will hear about some existing measures that help families pay for higher education, and what we can do to enhance their attractiveness.

We will then turn to the issue of school construction. We have all heard aboutand seen firsthand—the problems of disrepair and overcrowding in some of our na-

tion's elementary and secondary schools.

Before responding on impulse, however, we should consider several questions.

We need to ask ourselves whether state and local governments are adequately responding to the problem—whether the problem of dilapidated and overcrowded schools is getting better or worse. We then need to ask whether it is appropriate for the federal government to get involved, and whether state and local governments even want us to get involved And then we need to ask whether changes to the federal tax code are a desirable response to this issue.

Today's witnesses will give us some perspective on this issue. They will shed some light on the historical role of the federal government in this area and on the real

world reality of building schools.

PREPARED STATEMENT OF HON. CHARLES S. ROBB

I thank the chairman for having a hearing on such an important topic. I am supportive of many of the proposals which have been discussed here today, such as the employer-provided education assistance incentive and the allowance of deferred tax liability for prepaid tuition plans for our public colleges, and I think many of us are

supportive of these proposals.

The main issue I am concerned about is the need to address our school infrastructure problem. I believe there is a growing consensus among members on both sides of the aisle that Congress should provide some form of assistance to states struggling to meet their school infrastructure needs. So the question isn't whether we should provide money for school infrastructure, but rather how do we do it. In that vein, we do not suffer from a lack of proposals. From the House Republican leadership to many of the members in this body, we certainly have ideas that I think we can reach agreement on. So, it seems to me that the first two things we should decide are: (1) how much can we afford; and (2) on what aspects of the various proposals can we reach a consensus.

I look forward to working with all members of this committee to consider any proposals that will make our schools safe and healthy places in which to learn. Mr. Chairman, I'd like to submit for the record two studies pertaining to Virginia's school infrastructure needs—one completed by our General Assembly's Commission on Educational Infrastructure and one completed at the Thomas Jefferson Center for Educational Design at the University of Virginia. These studies were particularly eulightening, and I'd like other members to have the benefit of examining

some of the findings. Thank you.

Attachments.

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I. BACKGROUND OF THE STUDY

House Joint Resolution 135 of 1996 established this 23-member commission, with the following membership: the chairmen of the House Committees on Appropriations, Finance, and Education, and three members of the House Delegates; the cotions, Finance, and Education, and three members of the House Delegates; the co-chairmen of the Senate Committee on Finance, the chairman the Senate Committee on Education and Health, and two members of the Senate; eight citizens represent-ing commercial communications technology, educational technology, school design and construction, funding public school and capital construction, school design, the Virginia Municipal League, the Virginia Association of Counties, and the public at large; the Lieutenant Governor; the Secretary of Education; the President of the Board of Education; and the Superintendent of Public Instruction. All members served with full voting privileges.

Citing the age of many of Virginia's public schools, the need for public school in-

frastructure capable of supporting educational technology, the increasingly impor-

tant role of technology in business and industry, the necessity of planning revisions to adjust to evolving technology, the relationship of technology to student achievement, Virginia's role in communications technology, recent educational technology funding initiatives, and the benefits of a comprehensive examination of the state's educational technology infrastructure, HJR 135 directed the commission to accomplish the following objectives:

• Inventory and evaluate the physical and technical infrastructure needs of public

schools throughout the Commonwealth.

 Review current capital construction projects and estimate future public school construction and renovation needs.

Determine the technological needs of the public schools.

 Recommend appropriate alternative revenue sources for such construction and renovation, including ways to provide a sound and viable educational technology infrastructure for the public schools.

 Determine the level and source of funding required to support the infrastructure, and how to provide computers for all students by the year 2000, integrated instructional technology, in the classroom, networking, connection to the Internet, and staff development.

 Communicate and coordinate with the Select Committee on Public School Construction to facilitate consistency and avoid duplication and fragmentation of ef-

 Develop and recommend, in collaboration with the Select Committee on School Construction, an educational technology master plan which incorporates current networking and funding initiatives and provides a vision for meeting future school construction and educational technology needs as Virginia enters the 21st century.

The commission was directed to complete its work in time to report its findings and recommendations to the governor and the 1997 Session of the General Assembly. The commission's work was, however, continued by HJR 500 to the 1998 Ses-

sion.

II. SCHOOL CONSTRUCTION ISSUES

In recent years, school construction issues have been paramount in the minds of local school and government officials. Although the Commonwealth and the various local governments share the constitutional responsibility for funding the operation of public schools through the implementation of the Standards of Quality, local capital costs for public education fall squarely and solely on local governments. Localities are estimating school construction investments of \$4.1 billion in the next five years which will remedy less than two-thirds of known construction deficiencies of \$6.2 billion and will not correct the tendency to defer maintenance needs—a practice which increases long-term costs. Indeed, the picture is grim when one considers that figures obtained through on site capital improvement surveys indicate that school divisions underreport capital needs by 54 percent, therefore the real unmet capital construction need in Virginia's school divisions could exceed \$8.2 billion.

Although the Commonwealth of Virginia does not directly fund any school construction, a per pupil maintenance supplement appropriation is provided—currently \$15.00 per pupil (as recommended by this commission)—thereby helping every school division. The state also operates two interlinked debt mechanisms for funding school construction—the Literary Fund and the Virginia Public School Authority.

State Loan Programs

Originally established in 1810 as a statutory mechanism for funding the education of poor children, the Literary Fund was added to the Virginia Constitution in 1869. The Literary Fund endures as Section 8 of Article VIII of the Constitution of Virginia. This "permanent and perpetual school fund" is "held and administered by the Board of Education." The Fund provides direct loans for new construction, building additions or renovations, interest rate subsidies for projects funded through the Virginia Public School Authority, and moneys for other school purposes, such as teacher retirement and debt service on technology equipment notes, i.e., the purchase of computers and related technology.

The Virginia Public School Authority is a bond bank, offering low-cost financing for public education capital projects—thereby providing the localities with a cost-effective method of bond issuance and consistently Aa ratings. Two programs are offered—stand alone and pooled—with the pooled bond program's advantages being access to the bond market, low-cost financing, no requirement for voter referenda,

and no limit on loan amounts.

Scope of the Problem

Every other year, the Department of Education conducts the school facility status survey, documenting the condition of Virginia's schools and the estimated need for renovation or new construction. Providing a vehicle for self-reporting of school building conditions, this questionnaire is distributed to every school division in the Commonwealth. The resulting comparative statistical information on the school building deficiencies and capabilities encapsulates information for decision making and funding projections and charts the evolution of the Commonwealth's changing educational infrastructure.

The 1995-1996 school facility status survey shows that:

 Sixty-three percent of Virginia's public schools are over 25 years old and are in need of substantial renovation or replacement.

45 percent of school divisions utilize 3,621 mobile classrooms.

Many schools—30 percent—report overcrowded classrooms.
Twenty-seven percent of Virginia's classrooms are obsolete in terms of today's technological needs.

 Over the next five years, an estimated 13 percent increase in new classrooms will be needed—approximately 7,900 classrooms.

Fifty-two percent of the Commonwealth's school divisions report that school

maintenance is being deferred.

On the positive side, school divisions report a reduction in environmental concerns and increased building access for students with disabilities. The new data show energy efficiency in 62 percent of schools; air conditioning in 68 percent of schools; and access for the disabled is a reality in 74 percent of schools. In many school divisions, the learning environment, although showing steady improvement, still has many problems:

Approximately 400 schools in Virginia still have environmental concerns, such

as no emergency lighting, structural defects, and no fire alarms.

Other environmental issues including poor indoor air quality, lead, radon, as-bestos, and underground storage tanks are still concerns in certain schools.

Some school environment problems present a catch 22; for example, energy efficiency is a must for air conditioning, air conditioning is a must for computer technology and year-round use of buildings, and lack of energy efficiency eats up funds which could be allocated for these improvements.

School construction issues are exacerbated by increases in school construction costs in recent years that have far outpaced the general rate of inflation and by local economic pressures, with demands for services increasing more rapidly than revenue streams. Further, many school divisions report that 11 percent or more of their budgets are being dedicated to debt service and that future debt capacity may be limited.

As provided in the Virginia Constitution, the General Assembly may use Literary Fund moneys for public school purposes, "so long as the principal of the Fund totals as much as eighty million dollars." The economic exigencies of the early 1990s necessitated diversions of Literary Fund moneys for "other school purposes," with the choices being to maintain funding of the Standards of Quality or to maintain the capacity of the Literary Fund. Thus, funds were transferred for teacher retirement as a means of liberating general funds for other uses. The fiscal disturbances of the early 1990s resulted in sharp reductions in the capacity of the Literary Fund, with no loans being issued in fiscal years 1991, 1992, and 1993, and only \$23.2 million in loans being issued in fiscal year 1994.

In the last several years, the General Assembly has striven to restore the Literary Fund and, thereby, its capacity to fund school construction and renovation. Dependency on Literary Fund diversions has been reduced from a high of \$101.1 million in 1992 to a projected \$23.3 million in 1998. Although fiscal year 1995 began with a first priority waiting list of \$92.2 million, approximately half of which had been waiting for over a year and a number of which had been waiting for nearly two years, \$113.6 million in projects were funded during 1995-1996 and the waiting list

time has now been reduced to one year.

The Literary Fund's principal was reported as approximately \$338 million in June of this year. Revenues for 1996-1997 are projected to be \$110.7 million, with \$41 million to be transferred to teacher retirement, \$40.1 million to pay the second year debt service on the technology equipment notes, \$10 million for interest rate subsidy projects valued at approximately \$30 million, and \$50 million for direct loans.

III. EDUCATIONAL TECHNOLOGY ISSUES

As they head into the 21st Century, Virginia's children will be expected to be computer literate and technology savvy. The video-game generation must be prepared

to use advanced technology for research, analysis, and communication in the world of work and for recreation, socializing, shopping, banking, and other transactions in their private lives. Terminology such as "assistive technology" and "interactive media" will probably take on a "Brave New World" aura, with modifications and choices about which we can only speculate. In anticipation of these needs, Virginia's General Assembly has strongly supported educational technology since the 1980s. All major state education commissions since 1985 have recommended investments in educational technology. Since 1988, \$ 225.8 million in state-funded educational technology programs have been initiated, with various activities funded in 1988, 1990, 1994, 1995, and 1996. Local school divisions have also provided additional funding for educational technology.

Virginia's Grant Initiatives

Over the last several years, state educational technology grant initiatives for library automation have greatly increased Virginia schools' access to educational technology. In addition, the 1995 budget directs the Board of Education to dedicate over \$10.8 million from the Literary Fund to provide first-year debt service payments for an equipment grant program through the Virginia Public School Authority, in an amount estimated at \$46.5 million for the purchase of educational technology equipment. This year, the Superintendent of Public Instruction and the State Treasurer will recommend a continuing and stable funding mechanism for educational technology equipment and infrastructure. School divisions will also benefit from an agreement negotiated in the summer of 1996 for reduced telecommunications rates. In the 1996-1997 school year, grant funds, based on an average grant of \$26,300 per school and \$53,000 per school division, are being distributed to eligible schools for retrofitting and upgrading of existing buildings' infrastructure, networking, and equipment purchases. Localities are required to provide a 20 percent local match, 25 percent of which must be dedicated to teacher training.

Effects of Educational Technology

The enthusiasm among students and teachers that can be generated by educational technology is refreshing. Seated in his local classroom, a young student in the far Southwest or Eastern Shore of Virginia can take a tour of the white house or visit a museum or look for reference books in the Library of Congress. Next year, elementary students will be able to travel around the world—through virtual reality—if they have access to the Internet. This voyage will take two years; students will be able to direct the research conducted on this trip while traveling to such exotic destinations as Micronesia, New Zealand, Singapore, England, New York, and San Francisco.

Research on the effectiveness of technology in improving achievement, although not conclusive, has been positive, e.g., demonstrating improvements in attitudes towards school, access to information, and standardized test performance. Quicker mastery of basic skills through use of educational technology than traditional teaching methods has also been demonstrated, including writing, reading, and mathematics. How and when to use educational technology and the results of using educational technology continue, however, to be issues. A frequently heard caveat to the praise heaped on educational technology is that it is "only as good as the teacher using it." Indeed, the need for teacher training in the use of technology has been recognized in the General Assembly's initiatives. The Board of Education has adopted the Advisory Board on Teacher Education and Licensure Standards for Technology, noting that "many modern jobs require [technology] skills." As school divisions have increased their use of educational technology, many express the need for technical assistance for maintenance of hardware and troubleshooting of software. Thus, continued attention to training and technical support appear crucial to the success of educational technology, because the technology is evolving at such a rapid pace. Computers purchased today may be outmoded or inadequate by next year.

Six-Year Plan for Educational Technology

The Board of Education adopted a revised Six-Year Plan for Educational Technology in 1996 which sets out goals and implementation strategies to equalize access to educational technology. All school divisions in Virginia now have local educational technology plans. But school construction/infrastructure issues are inexorably related to educational technology. School environmental conditions present an educational puzzle; for example, energy efficiency is a must for air conditioning, air conditioning is a must for computer technology and year-round use of buildings, and lack of energy efficiency eats up funds which could be allocated for these improvements. Therefore, the infrastructure needs for effective educational technology are not cheap. Access to the World Wide Web requires adequate wiring and electrical capacity, funding for long-distance telephone rates, equipment purchases, and

replacement or upgrades of hardware and software—all high cost items! In 1995, the total implementation costs for the board's plan were estimated to be \$553.6 million, with approximately \$90 million per year over a six-year period. Because of the enormity of the cost estimates for comprehensive implementation, the appropriations for implementation of the board's plan have been, as already described, incremental and targeted.

Statutory Law

Although educational technology activities are healthy and progressing in Vir-Although educational technology activities are healthy and progressing in virginia, the statutory law related to educational technology is not specific or centrally located; much of the control of educational technology is contained in the budget. Some significant statutory provisions do exist. For example, the Virginia Public School Authority is authorized to make loans and interest rate subsidy payments for school capital projects which are defined in the law to include "motor vehicles and educational technology equipment" (§ 22.1-166.1). The Statewide Electronic Classroom Program is established in § 22.1-212.2; this program has been required to be available to every public high school since July 1, 1990. Having been, originally established only in the budget the initiatives recommended by the Commisnally established only in the budget, the initiatives recommended by the Commission on Equity in Public Education were mirrored in statute in 1995, i.e., § 22.1-199.1. Within the Standards of Quality, no specific requirements for educational technology are stated. Standard 6 (§ 22.1-1-253.13:6), relating to planning and public involvement, requires the Board of Education to develop and revise a statewide six-yea: improvement plan, with no mention of educational technology. Local boards are also required to have such plans which must include, among other components, technology "consistent with the six-year technology plan for Virginia adopted by the Board of Education . . ." In conflict with this requirement, the electronic classroom law (§ 22.1-212.2) requires the Board of Education to develop a five-year plan for

educational technology.
In 1997, educational technology issues focused on promoting access to educational technology for all public school students, a permanent funding mechanism for educational technology capital projects (retrofits, equipment purchases, etc.), public/private partnerships for educational technology, such as the negotiated reduced tele-communications rates and the many projects already being supported in the school divisions by business and industry, teacher training in technology, and clarification of the statutory authorities and responsibilities for educational technology.

IV. WORK OF THE COMMISSION

The first of the commission's four meetings, held on July 16, 1996, was its organizational meeting. The chairman and vice chairman were elected and decisions were made on the direction and structure of the study. In order to begin implementation of the study immediately, this meeting also included background briefings to establish the foundation for the study. This first meeting included a briefing on Virginia law related to school construction and technology and a review of the Virginia School Facility Status Survey as well as presentations on the Commonwealth's role in financing school construction, the status of the Literary Fund, and the Virginia Public School Authority. During this meeting, the commission requested certain data and analysis including information on the causes or reasons for inflation in the costs of school construction. The commission also reviewed and approved its study objectives and the proposed study plan and schedule.

In accordance with its study plan and schedule, the commission held four meet-

ings which were carefully planned and scheduled to complete its agreed-upon study plan and to provide a progression from background information and technical demonstrations to review of current issues and then decision making. Although the study plan included a fifth meeting—scheduled as a public hearing on the commission's proposals—this meeting was canceled because of the time constraints of the 1997 Session.

The commission's second meeting (September 10, 1996) focused on educational technology. The agenda covered many educational technology issues, including an technology. The agenda covered many educational technology issues, including an historical review of Virginia's Educational Technology Initiatives, a description of the Board of Education's current Six-Year Plan for Educational Technology, an overview of a local educational technology program (Charlotte County School Division), including presentations from the superintendent, a teacher, and three students; a demonstration of accessing the Internet by Charlotte County School Division students; and a review of implementation of the technology standards for instructional personnel then being recommended by the Advisory Board on Teacher Education and Licensure. This complex meeting also included three demonstrations from computer experts including two vanders. Representatives of IRM and an education puter experts, including two vendors. Representatives of IBM and an education technology consultant with Apple Computers demonstrated various instructional technology-all of which was very impressive and informative. In addition, the K-12 Technology Coordinator for the Fairfax County School Division spoke to the commission about the classroom of the future, including the school division's technology

standards and guidelines.

The third meeting, held on November 15, 1996, focused on current construction and funding issues. This meeting began with an overview of the study conducted by the Superintendent of Public Instruction and the State Treasurer pursuant to Item 131 G of the 1996 Appropriation Act. The two state officials were directed to "study the feasibility of establishing an elementary and secondary education equipment trust fund with purposes similar to the Higher Education Equipment trust Fund, and make recommendations to the chairmen of the Senate Finance and

House Appropriations Committees no later than November 1, 1996."

The recommendations were to include strategies for providing a continuing and stable funding level for the purchase, lease and/or replacement of educational technology equipment and infrastructure in Virginia's public schools, including the featibility of the purchase sibility and cost of direct appropriations for replacement costs through the Standards of Quality funding formula; potential sources of security for a financing program; the appropriate structure for administration of a program; appropriate levels of funding anticipated through the year 2000; the impact of a financing program on the Commonwealth's debt capacity and strategies for minimizing such an impact;

and the potential state and local costs of such a program.

This third meeting also included expert review of interim financing for school construction, i.e., financing between the time of applying for and receiving a Literary Fund loan or funding through the Virginia Public School Authority. This review was provided by an investment banker from Craigle, Incorporated. Further, two school superintendents presented their strategies for obtaining authority for local general obligation bonds through referenda. These presentations highlighted the potential for such authority in a rural county, i.e., Pittsylvania County, and an urban county, i.e., Chesterfield County.

The final presentation of this meeting focused on the relationship between building condition and student achievement and was presented by Dr. Carol S. Cash, Principal, Lee Davis High School, Hanover County Public Schools, who wrote her doctoral thesis on this subject.

The fourth and final meeting of the commission, held on December 17, 1996, was a wrap-up and decision-making meeting, covering a number of areas and issues. The meeting opened with a technology demonstration provided by Consulting Associates, Inc. of the CACTIS MultiPro Podium, a "real-time" interactive learning tool which is wireless, provides connecting links to multiple sites, and can be moved from room to room.

Pursuant to an information request of the commission, the Department of Education conducted a survey of school divisions to determine what kind and how many lease and lease-purchase arrangements were being used to fund technology. This survey was presented during this fourth meeting. Further, a review of local government spending for public education debt was presented to inform the commission about the extent and cost of public education construction/technology debt.

The meeting ended with a review by the commission of various issues and alternative solutions, including draft bills and letters. The commission reviewed and discussed these issues and possible solutions and decided to support twelve of these

choices.

V. FINDINGS

The Commission on Educational Infrastructure received much information, demonstrating the construction and technology needs of Virginia's public schools. Localities are estimating school construction investments of \$4.1 billion in the next five years, which will remedy less than two-thirds of the known construction deficiencies of \$6.2 billion. Figures obtained through on-site capital improvement surveys indicate that school divisions underreport capital needs by 54 percent; therefore the real unmet capital construction needs in Virginia's school divisions could exceed \$8.2 billion. These problems are exacerbated by increases in school construction costs in recent years. Further, many school divisions report that 11 percent or more of their budgets are being dedicated to debt service and that future debt capacity may be limited.

These are staggering figures, presenting enormous, but not insurmountable, obstacles. The Commission on Educational Infrastructure took some significant steps to improve this situation during the 1997 Session. These problems will, however, require long-term commitment and attention. The Commonwealth operates two construction funding programs which depend on the revenues flowing into the Literary

Fund, a constitutionally established, permanent and perpetual fund. The Constitution provides the General Assembly with the authority to use Literary Fund moneys for public school purposes, "so long as the principal of the Fund totals as much as eighty million dollars." The fiscal crises of the early 1990s made it necessary to transfer substantial funds from the Literary Fund and, without these transfers, funding of the Standards of Quality could have been affected. The tough, but fair, decisions that were made over those years of financial strain made it possible for

Virginia to thrive in a time of economic exigency

Recognizing that these accomplishments would not have been possible without the flexibility provided by the Virginia Constitution to use Literary Fund moneys for other school purposes, the Commission on Educational Infrastructure looked at measures other than efforts to restrict the use of these funds. However, the impact of Literary Fund transfers on the capacity of the Fund to make direct loans and the capacity of the Virginia Public School Authority to issue bonds was significant. Therefore, the commission requested the General Assembly to restrain the use of Literary Fund moneys for school purposes other than construction and other capital projects. The economic forecasts are good for 1996 and 1997withhi considerable reserves predicted. Thus, it is time for focusing on funding the vital construction and equipment needs of the Commonwealth's public schools.

VI. RECOMMENDATIONS

The recommendations for the first year study of the Infrastructure Commission were to:

1. Provide the Board of Education with the statutory authority to make Literary Fund loans for purchasing and installing educational technology equipment and infrastructure. This legislation was in support of the initiative to providlong-termin funding of educational technology developed pursuant to Item 131 of HB 30 of 1996.

HB 1835 (passed); Chapter 372, effective 7/1/97.
2. Provide local school boards with the statutory authority to establish, by themselves or with other parties or as regional efforts with other school boards, education technology foundations for the express purpose of implementing a public/private partnership to expand access to and improve the quality of educational technology in school divisions. HB 2285 (passed); Chapter 863, effective 7/1/97.

3. Require training for new and existing teachers and other instructional per-

sonnel in the use of educational technology.

4. Mandate technical assistance on professional development in education technology designed to seek to ensure that all instructional personnel are proficient in the use of educational technology.

Require all local school boards to provide a program of professional develop-ment in educational technology for all instructional personnel.

6. Require the public institutions of higher education to establish programs to ensure that all graduates have the technology skills necessary to compete in the 21st century and, particularly, that all students matriculating in teacher-training programs receive instruction in the effective use of educational tech-

- nology.

 7. Require the State Council of Higher Education, i n consultation with the Virginia Department of Education and the accredited teacher ed ucation programs of the Commonwealth's institutions of higher education, to deve lop guidelines to ensure that all students matriculating in teacher-training programs meet the standards embodied in Virginia's Technology Standards for Instructional Personnel and have the requisite skills for the implementation of the Board of Education's Six-Year Educational Technology Plan for Virginia.
- 8. Direct the State Council of Higher Education to consult with the Board of Education on its Six-Year Educational Technology Plan for Virginia and to encourage the public institutions of higher education to design programs to include the skills necessary for the successful implementation of the Plan.

 HB 1848 (passed); Chapter 827, effective 7/1/97.

9. Increase the per pupil amount for the School Building Maintenance Fund to \$15 (passed).

Item 140 C 9 in Chapter 924, effective 7/1/97.

10. Support the Virginia Public School Authority's Technology Resolution/ mechanism (passed).

Item 152 D of the Appropriation Act; Chapter 924, 1997.

11. Support the integrity of the Literary Fund by promoting reductions in the Literary Fund revenue diversions and by requesting the assistance and raising

the awareness of state and federal officials concerning the scope of the infrastructure problems.

Item 139, subdivision 5 of Chapter 924; effective 7/1/97.

HJR 662, expressing the sense of the General Assembly concerning use of Literary Fund moneys (passed).

Letter to Governor.

Letters to Chairmen of House Appropriations and Senate Finance Commit-

Letters to the members of the Virginia Congressional Delegation.

12. Continue the commission's work to examine the objective listed in HJR 135 of 1996 and to receive information on the feasibility of a one-time direct appropriation for school construction, a possible debt service funding program, and ways to enhance the Commonwealth's commitment to educational technology funding. HJR 500 (passed).

Respectfully Submitted.

THE HONORABLE DONALD S. BEYER, Jr., CHAIRMAN (1996) THE HONORABLE ALAN A. DIAMONSTEIN, CHAIRMAN (1997)

THE HONORABLE WARREN E. BARRY THE HONORABLE JOSEPH E. BROOKS THE HONORABLE MALVERN R. BUTLER THE HONORABLE JOHN H. CHICHESTER THE HONORABLE J. PAUL COUNCILL, JR. THE HONORABLE C. RICHARD CRANWELL THE HONORABLE V. EARL DICKINSON THE HONORABLE JAMES H. DILLARD II THE HONORABLE JAMES W. DYKE, JR. THE HONORABLE MARK L. EARLEY THE HONORABLE MICHELLE EASTON THE HONORABLE JOE ELLIS THE HONORABLE RICHARD T. LA POINTE THE HONORABLE GLENN LITTLE THE HONORABLE ARTHUR MCKINNEY THE HONORABLE ROBERT W. MOJE THE HONORABLE PHILIP A. ODEEN THE HONORABLE BEVERLY H. SGRO THE HONORABLE STANLEY C. WALKER THE HONORABLE MARY MARGARET WHIPPLE THE HONORABLE CLIFTON A. WOODRUM

WHERE OUR CHILDREN LEARN MATTERS: A REPORT ON THE VIRGINIA SCHOOL FACILITIES IMPACT STUDY

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DANIEL L. DUKE AND JACQUELINE GRIESDORN WITH ASSISTANCE FROM MONICA GILLESPIE AND J. B. TUTTLE

THE THOMAS JEFFERSON CENTER FOR EDUCATIONAL DESIGN UNIVERSITY OF VIRGINIA

DECEMBER 1998

School construction has risen to the top of the political agenda across the nation. Virginia is no exception. In some parts of the Commonwealth, rapidly increasing enrollments and population shifts have necessitated new schools, extensive additions, and an armada of mobile units. Elsewhere school enrollments are relatively stable. but aging facilities are forcing communities to renovate, retrofit, or replace schools.

The need for new and updated schools for the children of Virginia is not in question. Periodic surveys by the Virginia Department of Education have established beyond a reasonable doubt the range and scope of the need. Still, school construction is expensive, and some people question whether there is any relationship between the quality of school facilities and student achievement.

In an effort to understand better the connection between facilities, on the one hand, and learning and reaching, on the other, the Virginia Association of School Superintendent commissioned the Thomas Jefferson Center for Educational Design to conduct a survey of the Commonwealth's school divisions. Located at the University of Virginia, the Thomas Jefferson Center is a non-partisan research and development organization involving associates from the fields of education, architecture, engineering, technology, business, and sociology.

A STUDY OF IMPACT

While other surveys have concentrated on describing the extent of facilities needs, the Jefferson Center survey focuses on the impact of overcrowded and deteriorating facilities on learning and reaching. Survey questions reflect five areas of concern:

1. Instructional time lost because of problems related to facilities 2. Reduced effectiveness of reaching and learning due to facilities

3. Diminished curricular options

Pressure on facilities resulting from state and federal mandates

5. Student health and safety issues related to facilities

In November of 1998 every Superintendent in Virginia received a copy of the Jefferson Center's four-page "School Facilities Impact Survey." Of 133 possible responses, 128 (96%) were returned. The following sections contain the results of the survey and several recommendations for policy makers.

LOST INSTRUCTIONAL TIME

If research has established any relationship in education, it is that which exists between time and learning. The more time students are exposed to instruction, the more likely they are to learn. It goes without saying that when students are not in school, achievement suffers. The survey reveals that 36.2% of the 128 school divisions were forced to close one or more schools during the past two years because of problems related to school facilities. Lost time ranged from an early dismissal due to lack of air conditioning to ten days without school because of a heating system failure. Survey responses indicate that at least 96 days of instruction have been lost in Virginia public schools since the beginning of 1997. Schools had to be dismissed early on at least 44 other occasions. In some instances, only one school was involved in a facilities-related closure or early dismissal, but in cases involving lack of air conditioning during extremely warm days, every school in a division had to be closed! Tens of thousands of students were affected.

Virginia school divisions in the past two years have lost more than 38 days of instruction due to lack of air conditioning and have been forced to dismiss school early due to hot weather on more than 40 occasions. These statistics, of course, do not include the warm days when schools remained open, but students and teachers were

uncomfortable and unable to function effectively.

The importance of air conditioning becomes even more apparent in the summer. An increasing number of school divisions are running extensive summer programs, particularly for students who have fallen behind their peers or failed statewide tests. To require these students to attend school during hot weather months without

air conditioning makes little sense educationally.

Lack of air conditioning is not the only reason for lost instructional time in Virginia, though it was the most frequently mentioned. Problems related to HVAC (Heating, Ventilation, and Air Condition) systems accounted for 39 days of lost instruction, electrical systems and wiring another 10 days, and water and sewer problems an additional 6 days. Most of the HVAC problems involved boiler failures Juring winter months. The data do not include the impact of leaking roofs on particular classrooms, since schools typically remain open in the case of isolated leaks.

REDUCED EFFECTIVENESS

When school is closed, formal learning does not occur. But what about when school is open? Inadequate facilities can exert a sufficiently negative impact to reduce the ability of teachers to teach and students to learn. Nowhere is this impact more apparent than in schools that lack an adequate number of classrooms to support their educational programs.

Insufficient classroom space compelled 53 % of the school divisions to increase the numbers of students in at least some classes, thereby countering local and state ef-

forts to improve student achievement by lowering the ratio of students to teachers. Over 40% of the school divisions report having to combine classes, such as Spanish III and Spanish IV, in order to cope with space limitations. Combining classes forces teachers to handle several preparations simultaneously, thereby jeopardizing curriculum coverage and instructional effectiveness. In other cases, inadequate space has meant that two teachers must operate in the same classroom space with dif-ferent groups of students—at the same time!

In order to deal with limited space, 63% of the school divisions schedule classes for areas not designed for instructional purposes. For example, 34 divisions (27 %) hold classes in auditoriums or on stages; 20 divisions (16%) hold classes in cafeterias; and 20 (16%) divisions hold classes in storage areas and book closets. Other areas used for instruction include hallways, offices, media centers, teacher workrooms, locker rooms, and, in two cases, converted coal bins.

In several cases, science labs must meet in rooms without gas or water. The need for classroom space sometimes means eliminating areas that play an important role in instructional support and school operations. Fifty-six per cent of the school divisions report eliminating important non-instructional areas in order to create more classrooms. Among the areas converted to classrooms are administrative and professional offices (23%), storage rooms (19%), teachers' workrooms (14%). When teachers lack space in which to prepare instructional materials, speech therapists lack private rooms for testing and consultation, and parts of libraries must be used as classrooms, the ability of schools to deliver their instructional programs can be com-

Converting existing building space to classrooms is not the only way school divisions in Virginia are coping with the need for more places to teach. Sixty-seven per cent of the school divisions have purchased mobile units and more than 30% are leasing them. Over 3,000 mobile units are scattered over the campuses of the Commonwealth. To point out that mobile units pose challenges for teachers and school officials is to risk understatement. Among the potential problems are the following:

• Wiring mobile units for computers in difficult and expensive.

 Mobile units often lack water and other features that are important for certain courses, such as art, home economics, and science.

Some students feel stigmatized when they are compelled to spend all or part

of the day in mobile units.

Valuable instructional time can be lost when students must walk back and forth between mobile units and the main school building.

· Walking to and from mobile units creates opportunities for misconduct and dis-

cipline problems.

 Keeping expensive equipment such as computers in mobile units poses a security problem.

Mobile units often are not energy-efficient.

Besides forcing students to learn in unsuitable settings and depriving school employees of space for planning and preparation, squeezing classroom space out of existing facilities can have another, more subtle impact. This impact is best captured in a statement by one of the respondents to the survey:

Improper facilities for classroom instruction—such as storage rooms, teacher lounges, auditorium stages, and mobile units—send a silent message that the students, staff, and programs are not important enough to require additional

funds to correct these deficiencies.

DIMINISHED OPTIONS

Lack of adequate classroom space limits curricular choices as well as teacher effectiveness. One out of every five divisions (20%) report being forced to cancel or eliminate courses because of space limitations. Among the victims are many voca-

tional education courses and electives.

Even school divisions that succeed in preserving curricular options are still forced to make concessions. Access to certain courses and programs, for example, had to be limited by almost 16% of the reporting divisions. Vocational education courses, once again, were among those most affected by limited space. Other areas where enrollment has been restricted include programs for four-year-olds, alternative education, advanced placement courses, and computer courses. It appears that at-risk students and students who are unlikely to attend college often are those for whom curricular choices are curtailed because of inadequate space.

STATE AND FEDERAL MANDATES

When schools are built, they are built to accommodate educational programs that meet existing expectations. Expectations change, however. Nowhere have expecta-

tions changed more dramatically than in the area of special education. Many of the space limitations faced by Virginia's schools can be traced to federal legislation regarding the education of special needs students. Almost a quarter century after the passage of Public Law 94-142, some school divisions in Virginia still do not meet building standards for access for students with disabilities.

Currently school divisions are implementing the Virginia Standards of Learning and the Standards of Accreditation. Many survey responses indicate that these new mandates are placing additional strains on existing facilities. One school division enumerated a variety of reasons why state and federal mandates necessitate more

space:

Need to reduce enrollment in K-3 classes to an average of 20 students.
Need to reduce enrollment in 6-12 English classes to an average of 24 students.

Need for special education rooms to meet federal and state guidelines.

 Need for tutorial rooms for students requiring reading remediation (Virginia Reading Tutor Program). Need for space for additional teachers to provide remedial assistance to students who fail SOL tests.

More computer labs to help students meet new SOLs related to technology.

 More space for technical labs to accommodate state is desire for student preparation for technical careers.

Additional class space to accommodate students who are retained as a result

of failing SOL tests.

Over 72% of the school divisions indicate that classrooms will have to be increased to meet some or all of these new expectations. One urban division, for example, will need to add 60 classrooms in order to lower teacher-student ratios in K-3 to an average of 20 students. To address Standards of Learning related to laboratory sciences, almost 64% of the school divisions say they will need to increase their number of science labs. Three out of four divisions indicate they must add computers and space to accommodate them in order to meet technology-related Standards of Learning.

Both Governor Gilmore and President Clinton have suggested that funds be made available to enable school divisions to hire more teachers. When asked whether some schools in their divisions would be unable to add more teachers unless additional classrooms were constructed, 86% of the respondents agreed. Obviously there

is more to expanding the teaching force than recruitment and selection.

STUDENT HEALTH AND SAFETY

Virginia educators care deeply about their students, and they make every effort to ensure their health and safety. Still, 7% of the respondents report that facilities related problems in the past two years have resulted in injuries to students and student absenteeism. Specific problems range from a student falling through a rotten section of flooring to absences associated with building-based allergies and poor ventilation.

Overcrowding can produce its own set of safety problems, including increased opportunities for misconduct in classes and corridors. Sometimes overcrowding and lack of adequate space lead parents to withdraw their children from school. Seventeen percent of the school divisions indicate that students have been withdrawn from at least one school because of facilities-related problems.

SCHOOL FACILITIES MATTER

Based on surveys from 128 out of 133 school divisions in Virginia, it can be concluded that school facilities do matter when it comes to learning and teaching. To ignore or minimize the connections between what students learn and where they

learn, in our judgment, would be a serious mistake.

Virginia's educators understand how facilities affect learning and teaching. They are continually assessing building and classroom needs. Unfortunately, they are not always able to secure the funds necessary to improve existing facilities and build new schools. Just under one quarter of the school divisions in our survey report having tried and failed to obtain funds for new construction or renovations during the past two years. A number of school divisions in the Commonwealth clearly require assistance if they are to provide their students with up-to-date, comfortable, and effective learning environments.

The need is best expressed, perhaps, in the words of one Superintendent:

We have already had to add 26 mobile units to address overcrowding and reduced K-3 class size, and we are still short of space in several areas. Twentyfour of these mobile units are used as regular classrooms; this means that 20% of our regular classroom teachers are now housed in mobile units. Mobile units are not connected to the school's computer network.

None of the schools in the division are air conditioned, and all but one of the boilers are 20 to 30 years old. Wiring and lighting are inadequate for classroom instruction and the use of technology. Students with health problems are frequently affected by the schools being too hot or cold. Students in mobile units are affected by having to change classes in bad weather. It is also very difficult to schedule summer school and remedial classes in un-air-conditioned classrooms.

Four recommendations derive from the findings of the Jefferson Center's "School Facilities Impact Survey." All but one involve providing state support to help school divisions provide learning environments capable of supporting Virginia's high expectations for students and teachers. Less affluent school divisions should not be placed in the position of having to choose between maintaining or improving school facilities and other essential budget items such as hiring teachers or purchasing instructional supplies.

Recommendation 1: Provide state support to help school divisions provide air conditioning for every school. Effective learning and teaching is virtually impossible in hot, humid classrooms that lack adequate ventilation. The need for effective classroom learning time has never been greater in Virginia. In addition, summer programs for at-risk students are increasing. Air conditioning is imperative.

summer programs for at-risk students are increasing. Air conditioning is imperative. Recommendation 2: Provide state support to offset the negative consequences of out of-date and deteriorating facilities. No student in Virginia should be compelled to attend schools with inadequate wiring, leaky roofs, outdated boilers, poor lighting, and classrooms that are not designed for effective instruction. No student's safety or health should be jeopardized because of the facilities in which they are required to learn.

Recommendation 3: Provide state support to relieve overcrowded conditions in schools. Overcrowding adversely affects learning in various ways. Access to important courses may have to be limited. In some cases, courses are eliminated entirely because of limited space. When teachers must teach large numbers of students, the likelihood that individual students will receive the individual attention they need and deserve is greatly reduced. Crowded conditions also spawn behavior problems and disorder.

Recommendation 4: Establish high state-wide standards for school facilities. It seems only fair that a state that expects high performance from its students and teachers should also hold itself, and its citizens, to a high standard when it comes to support for schools. This support includes providing high quality school facilities to provide young people with every opportunity to take advantage of their public education. What message do we send to Virginia's young people when we demand that they me et rigorous academic standards, but then allow communities to settle for sub-standard school facilities?

PREPARED STATEMENT OF HON. JEFF SESSIONS

Mr. Chairman, distinguished members of the Committee, I would like to thank you for holding this important hearing to discuss education reform and education tax issues. Education is clearly the American public's number one issue and I am honored to be able to discuss the concept of prepaid tuition plans and why they are critically important to American families.

Mr. Chairman, as you know, American families have accrued more college debt in the 1990's than during the previous three decades combined. The reason is two-fold: the federal government subsidizes student debt with interest rate breaks and penalizes educational savings by taxing the interest earned on those savings.

In recent years, however, many families have tackled rising tuition costs by taking advantage of prepaid college tuition and savings plans. These plans allow families to purchase tuition credits years in advance. By the year 2000, 42 states will have a prepaid tuition program, a savings program or both. These plans are extremely popular with parents and students. They make it easier for families to save for college, while at the same time taking the uncertainty out of the future cost of college.

Mr. Chairman, over the years, Congress, under the your sand Senator Moynihan's leadership, has supported participating families by expanding the scope of the prepaid tuition plans and by deferring the taxes on the interest earned until the student goes off to college. Because of these Congressional actions the prepaid tuition trend is continuing. Now a nationwide consortium of more than 100 private colleges, located in 32 different states, with more than I million alumni, have established these same type of tuition savings and prepaid tuition plans as well.

Under the CLASS Act, families choosing to save for a private college education would receive tax-free treatment in 2004 while families with savings in a public prepaid plan would benefit immediately. This is not a benefit for the colleges, rather, this program is an incentive for students and families to save for the college of their choice. In that regard, this program is much like the Guaranteed and Direct Student Loan Program, the G.I. Bill or the Pell Grant program, which allow families to the college of their choice. to use federal assistance at the college of their choice.

The CLASS Act will make all of the interest earned in prepaid plans completely tax-free. Currently, the interest earned by families saving for college is taxed twice. Families are taxed on the income when they earn it, and then again on the interest that accrues from the savings. On the other hand, the federal government subsidizes student loans by deferring interest payments until after graduation. It is no wonder that families are going heavily into debt and at the same time are struggling to save for college. Mr. Chairman, I strongly believe that this trend must no longer con-

tinue.

In order to provide families a new alternative, the CLASS Act would provide tax-free treatment to all pre-paid savings plans. This bipartisan piece of legislation is sound education and tax policy that provides incentives for savings rather than bureaucratic solutions. For a small cost the CLASS Act will provide billions in potential savings to help families afford a college education. The Joint Committee on Taxation has scored this bill at \$179 million over 5 years and \$697 million over 10 years. Unfortunately, the Joint Tax Committee did not consider any potential savings from the inevitable reduction in the dependency of the families on federal school loans, grants or the benefits to the country from increased savings.

Mr. Chairman, many individuals have questioned whether these plans will benefit all types of students. It is wrong to assume that tuition savings and prepaid plans benefit mainly the wealthy. In fact, the track record of existing state prepaid plans indicates that working, middle-income families, not the rich, benefit the most from

pre-paid plans. For example:
• 71% of the participating families in the Florida Prepaid College Program have annual incomes under \$50,000 and 25% have incomes of less than \$30,000;

72% of the tuition contracts in the Alaska Advance College Tuition Payment Plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families plan have been purchased by families of the contracts in the Wyoming savings plan have been purchased by families are purchased by families are purchased by families are purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contracts plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than \$47,500; 81% of the contract plan have been purchased by families with annual incomes of less than have been purchased by the cont

ilies with annual incomes of less than \$34,000; 62% of the contracts in the Pennsylvania plan have been purchased by families with annual incomes of less than \$35,000;

36% of participating families in the Texas Tomorrow Fund program have an-

nual incomes of less than \$50,000; and

The average monthly contribution to a family's college savings account during 1995 in Kentucky was \$43.

Tax free treatment for all prepaid tuition plans must become law. The federal government can no longer subsidize student debt with interest rate breaks and penalize educational savings by taxing the interest earned by families who are desperately trying to save for college. The inclusion of the CLASS Act in any tax bill this Committee passes will allow us to meet these goals. Once these goals are achieved, the federal government would no longer be penalizing families for saving but rather be providing families the help they need to meet the cost of college through savings

rather than through debt.

Mr. Chairman, I'd like to thank you again for giving me the opportunity to testify here today and I look forward to working with you over the coming months on these and other initiatives which will help America's families afford a college education.

The Collegiate Learning and Student Savings (CLASS) Act

"A commonsense piece of legislation which will help nearly 30 million students afford a college education"

United States Senator Jeff Sessions
United States Representative Joe Scarborough

American Families Have Already Accrued More College Debt in the 1990's Than During the Previous Three Decades Combined

THE REASON IS TWO-FOLD:

- The federal government subsidizes student debt with interest rate breaks, and
- Penalizes educational savings by taxing the interest earned on those savings

IT IS NO WONDER THAT FAMILIES ARE STRUGGLING TO SAVE FOR COLLEGE!!!

The CLASS Act is Sound Public Policy

- In recent years, however, many families have tackled rising college tuition costs by taking advantage of prepaid college tuition and savings plans. These plans allow families to purchase tuition credits years in advance
- Unfortunately, the federal government penalizes educational savings by taxing the interest earned on those savings

The CLASS Act eliminates this double taxation

 Under the CLASS Act, the federal government would no longer be penalizing families for saving but rather be providing families the help they need to meet the cost of college through savings rather than through debt

A Commonsense Piece of Legislation Which Will Help Nearly 30 Million Students Afford a College Education

- By the year 2000 42 states will have a prepaid tuition program, a savings program or both
- Now, a nationwide consortium of more than 100 private schools, located in 32 different states, with more than 1 million alumni, have launched a similar plan
- A September 25, 1998 Heritage Foundation Report estimated nearly 30 million children could benefit from the CLASS Act

The CLASS Act Extends Tax-free Treatment to All Plans

•The CLASS Act would provide state prepaid plans tax-free treatment in 2000, and private prepaid tuition programs would become tax free in 2004

For a small cost, the CLASS Act will provide sound education and tax policy that promotes savings

Joint Tax Score:

\$197 Million over 5 years

S697 Million over 10 years

93

Who Will Benefit From The CLASS Act?



State	# of Children	State	# of Children	
Mabama	492,466	Montana	90,546	
Alaska	71.154	Nebraska i	210,860	
Arvona	410,918	Nevada	121,331 2	
Arkansas	240,212	New Hampshire	130,055	
California	3.620,768	New Jersey	904,025	
Colorado	407,833	New Mexico	182.576	
Connecticut	398,994	New York	2.212,882	
Delaware	96,260	North Carolina	661,558	
DC	34.419	North Dakota	89,667	
Horida	1.074,266	* Ohio	1.145,415	
Georgia	804,086	Oklahoma	293,067	
Hawaii	116,796	Oregon	314,586	
Idaho	117,277	Pennsylvania	1.283.666	
Illinois	1,567,482	Rhode Island	106,057	
Indiana	619,583	South Carolina	381,975	
Lowis	431,401	South Dakota	70,188	
Kansas	330,594	Lennéssee	517,979	
Kentucky	325.629	Lexás	1,800,159	
Louisiana	379.304	Utah	291,936	
Maine	92.610	Vermont	38,227	
Maryland	548,001	Virginia	564,675	
Massachusetts	750,127	Washington	631,089	
Michigan	1,143,808	West Virginia	111,924	
Minnesota	569,519	Wisconsin	653,011	
Mississippi	333,543	Wyoming	55,726	
Missouri	547,080	. Total	28,407,150	

Who Really Benefits from Tuition Savings Plans?

The track record of existing state prepaid plans indicates that middle-income families, NOT the rich, benefit the most from prepaid plans

- 71% of the participating families in the Florida Prepaid College Program have annual incomes under \$50,000 and 25% have incomes of less than \$30,000
- * 72% of the tuition contracts in the Alaska Advance College Tuition Payment Plan have been purchased by families with annual incomes of less than \$47,500
- 81% of the contracts in the Wyoming savings plan have been purchased by families with annual incomes of less than \$34,000
- 62% of the contracts in the Pennsylvania plan have been purchased by families with annual incomes of less than \$35,000
- * 36% of participating families in the Texas Tomorrow Fund program have annual incomes of less than \$50,000
- * The average monthly contribution to a family's college savings account during 1995 in Kentucky was <u>S43</u>

(The Census Bureau reports that the median income for a family of four is \$49,687),



The CLASS Act Will Help Nearly 30 Million Students Afford a College Education!

- Current Senate cosponsors: Senators Graham, Mack, Abraham, Coverdell, Cochran, Murkowski, Craig, Torricelli, Grams & Hutchinson
- Current House cosponsors: Representatives DeLay, Goodling, McKeon, Weller, Miller, Boucher, Riley, Mascara, Salmon, Ewing, Chenoweth, Schaffer, Gilman, Manzullo, Taneredo, Watkins, McCollum, Ros-Lehtinen, Hostettler, Paul, Pitts, Hayes, Sununu, Mica, Canady, Foley, Shows, Granger, Radanovich, Souder, Pombo, Jones (OH), Hefley, Diaz-Balart, Graham, Ehlers & Peterson (PA)
- Contact Jim Hirni x4-3972 or Dan McFaul x5-5459 for additional information or to cosponsor <u>S.13</u> or <u>H.R.254</u>

Prepared Statement of Octavio J. Visiedo

Mr. Chairman, Senators, my name is Octavio J. Visiedo and I would like to begin by thanking you for giving me the opportunity to share with you some of my experiences related to school construction as Superintendent of Schools of the fourth largest school district in the nation and in my new role as a private sector entrepreneur.

My history with Dade County Public Schools began in 1961 as an immigrant 5th

grade student and culminated with my selection as Superintendent of Schools at the age of thirty nine. In large part I was selected due to my success in dealing with Dade County's \$1.5 million capital construction program which at the time was the largest program in the history of American public education. However, the depth and breadth of the problems that plagued our construction efforts were as substantial as the size of the program. The problems were exacerbated by the incredible growth that faced our school district. In Dade County, like many other larger urban districts, growth is fueled by immigration and that creates additional pressures for school districts because these children need greater support in order to achieve academic success. During my tenure as Superintendent Dade County Public Schools enrollment increased 10,000 to 12,000 new students per year, and most of them were foreign born. These students also create different mobility patterns within the school district. These patterns placed additional stress to a struggling, school system that was trying to implement a complex construction program in an environment that had overwhelming regulatory and policy related obstacles.

Early in my administration I attempted to formulate a series of recommendations designed to trasform the construction program into a more efficient one in an attempt to keep pace with the growth. The regulatory obstacles affected cost, time and quality of construction. An example of the type of changes that were proposed dealt with the manner that design professionals were selected and the number of times that the prototype design could be utilized. School board policy provided preference for inexperience and limited the use of a prototype design to only three uses. This policy increased costs, caused more change orders, rewarded incompetence and dra-

matically slowed down the pace of our construction efforts.

Another policy issue that dramatically affects budgets deals with site acquisition practices. Most urban school boards have unrealistic acreage and design standards thereby making the acquisition of property extremely time consuming and costly. Finding approximately forty acres for the construction of a high school in a large county located within a growing state makes it literally impossible to secure property in a timely manner. Furthermore, requirements that limit the height of the structure thereby demand that a larger foot for the structure be established.

In my current role as an educational entrepreneur I have been able to adopt best practices from my experiences as a public employee while also employing private sector strategies designed to operate a more efficient building and placing those resources back into the classroom. To this point, I would like to share with you a practical example. In the Pembroke Pines public/private partnership model I made a conscious design decision that had a profound impact on both the initial capital expenditure therefore affecting the debt service and on ongoing operational costs. In our school we designed a multi-purpose room that serves as a lunch room and has a warming kitchen in lieu of a full service kitchen. By doing this we saved hundreds of thousands of dollars on the capital side thereby reducing the debt service and since we contracted food services with a private provider and lunches come fully prepared we were able to reduce dramatically recurring personnel costs. The result is a food service program that exceeds all standards set up by the local school board and has been monumentally popular with students, parents and school personnel. The lunch program is currently administered by one full time person and a small group of parent volunteers.

It is important to acknowledge that Dade County in so many ways is a microcosm of public education. It is so large and diverse in its student demographics that it could be representative of most school districts in the nation. In Homestead, Florida schools are located primarily in rural, agricultural areas, and their challenges are substantially different than those faced in Liberty City which is a predominantly African American community in an urban setting. Because of these dynamics we were forced to utilize a variety of strategies to capitalize our capital construction efforts. Any initiative that provides school districts with additional funding sources such as low interest construction financing would enable districts like Dade County to address explosive and unforeseen growth patterns in a timely and cost efficient manner. Providing school districts with a "cafeteria" of funding options for their use based on their individual needs can do nothing but help school districts that are

struggling to address school overcrowding.

Inherent in this suggestion is the premise that only school districts that have demonstrated a capacity to implement their strategic capital construction plan in a cost efficient manner can qualify for these funding sources. Furthermore these districts must also demonstrate that there is an authentic unforeseen and unfunded need that could not have been anticipated and could not be addressed by utilizing

existing resources.

I have attempted to provide you with a brief series of observations of key issues that if addressed properly could help districts become more effective in administering their construction programs and would also assist them in addressing the explosive student growth that is affecting public schools throughout the nation. Once again, let me express my gratitude for allowing me to share these observations and I am prepared to respond to any questions you may have regarding my testimony.

Prepared Statement of Dr. Dennis Zimmerman

State and local governments historically have assumed most of the financial responsibility for public elementary and secondary schools. They raised about 92 percent of total school revenue for school year 1995-96; the federal government contrib-

uted about eight percent of revenue.

Federal financial support can be divided into two major components. Direct federal support provided by on-budget spending programs in school year 1995-96 amounted to \$19.1 billion (as measured by the states), 6.6 percent of total school revenue. The federal policy objectives of this direct federal spending are fairly clear: 55 percent of this assistance in fiscal year 1995 targeted disadvantaged children; another 22 percent targeted disabled children; 12 percent targeted school system support for such things as professional development and drug abuse education; and six percent targeted children whose parents live and/or work on federal property.(1)

Indirect federal support for capital facilities is provided through the tax system.

The interest income individuals and businesses earn on state and local debt is excluded from their taxable income. This exclusion lowers the interest rate on statelocal debt, a reduction in effect paid for by the federal tax revenue not collected on the excluded interest earnings. The estimated revenue loss on school facilities bonds amounted to \$3.7 billion in 1996, about 1.2 percent of total education revenue.(2) The federal government imposes no limit on the amount of tax-exempt bonds state-

local governments may issue for governmentally owned school facilities.

Unlike federal direct spending for public elementary and secondary schools, this tax subsidy is not motivated by a federal education policy objective. Its existence is a byproduct of the income tax structure established in 1913 which incorporated the concept that the various levels of government should refrain from taxing each other. As a result, the tax subsidy is identical for all state-local capital facilities—schools, roads, hospitals, parks, etc.—and does not affect state-local taxpayer choices among different types of facilities.

In summary, three facts stand out about federal financial support for public ele-

mentary and secondary schools:

It is minor compared to state-local support.

On-budget spending is targeted to four major policy objectives (the disadvan-

taged, the disabled, system support, and the federally impacted).

• The major tax subsidy was not adopted to pursue a federal education policy objective, and has been structured not to influence state-local taxpayer choice among capital facilities for different public services. The State-Local Sector and America's Public School Facilities

Attention recently has focused on the deficiencies of public elementary and secondary school capital facilities. Studies have suggested that as much as \$112 billion of investment may be necessary to restore school facilities to good overall condition, and that the resources of many local school districts are inadequate to rectify the

It is useful to evaluate this information in an economic context. The gap between "good overall condition" of school facilities and their current condition is a serious problem not to be minimized that undoubtedly has an adverse impact on human capital formation. But budget constraints are a fact of life: our desire for both private and public spending (consumption) exceeds our ability to pay for it. It is likely that a similar study assessing the condition of state-local capital facilities for any function—roads, sewage treatment plants, prisons—would reach a similar conclusion. (4) A gap exists between the "good overall condition" of the capital stock we desire and the less-than-good overall condition we choose to live with.

When making hydrat allocation decisions state local decision realess.

When making budget allocation decisions, state-local decision makers decide where to spend additional tax revenue based in part upon their assessment of which activity will provide the highest return or value. It is a given that positive returns will result from additional investment in almost any activity funded by state-local budgets. But a ten percent return in education facilities will not be funded if decision makers judge a twelve percent return is available in sewage treatment facilities. In other words, one must consider the possibility that state-local decision makers made their spending decisions with complete information; that they chose the existing less-than-good condition of education facilities because they place a higher value on spending the available tax revenue for private consumption or other state-local services.

For the Nation as a whole, state-local taxpayers have not been neglecting education facilities. Table 1 presents referendum data on public elementary and secondary school bond issues for the years 1988 through 1998. The percentage of bond issues approved and the percentage of dollars approved appear in columns 2 and 3. Both series tell approximately the same story. Approval rates declined substantially in the early 1990s, reaching a low of 49.9 percent for Issues in 1991 and 48.4 percent for Dollars in 1993. Since those lows, the approval percentage for both Issues and Dollars has risen substantially. The 1998 approval rates of 66.8 percent for Issues and 82.4 percent for Dollars are now higher than the levels that prevailed in 1988.

TABLE 1. SCHOOL BOND REFERENDA 1988-1998: APPROVAL RATES FOR ISSUES AND DOLLARS

	Year	Share of Issues	Share of Dol- lars
1988		0.657	0.770
1989	***************************************	0.580	0.730
1990		0.573	0.70
1991		0.499	0.490
1992		0.532	0.604
1993		0.568	0.48
1994		0.592	0.51
1995		0.553	0.54
1996		0.586	0.69
1997		0.619	0.61
1998		0.668	0.82

Source Securities Data Company

The increasing approval rates are consistent with the 7.7 percent real annual growth rate of school bond volume (dollars of new issues) that occurred from 1979 through 1998. This is not surprising. We are now in the longest uninterrupted economic expansion in the Nation's history, during which the state-local surplus rose from \$80.1 billion in 1990 to \$148.7 billion in 1998. As real income rises, state-local taxpayers can be expected to spend more on a wide range of public services, including investment in schools. But these bond data do not provide evidence about how much of the growing bond volume was necessary to keep pace with growing student enrollment and whether schools were faring better or worse than other state-local services.

Table 2 compares the 7.7 percent real annual growth rate of school bond volume over the last two decades to the rates for school-age population (ages 5 to 19) and state-local receipts net of federal grants.

The school-age population grew at a 0.2% annual rate, so most of this 7.7 percent real annual increase in bond volume was devoted to maintaining or improving the facilities of a relatively stable school population. State-local receipts net of federal grants grew at a 4.1 percent real annual rate. These data suggest state-local tax-payers have been devoting an increasing share of own-financed revenue to schools, and school construction spending has fared better than all other functions combined.

TABLE 2. SCHOOL NEW-ISSUE BOND VOLUME AND OTHER ECONOMIC INDICATORS, 1979-1998: REAL ANNUAL GROWTH RATES

School Bond Volume	Population Ages 5-19	State-Local Receipts Net of Federal Grants
7.7%	0.2%	4.1%

Of course, these aggregate data undoubtedly mask a considerable amount of variation among states and school districts. Several circumstances arise which may cause school districts to provide grossly inadequate school facilities, and alleviation of some of these circumstances may be consistent with historical federal policy objec-

tives for financing public elementary and secondary education.

• A district might suffer from inadequate fiscal capacity; residents may be poor and the district may lack significant commercial and industrial property tax base. If its state does not have a vigorous fiscal equalization program for education finance, resources may not be available to provide minimal capital facili-

Some school districts might experience a substantial influx of retirees, or be at the height of a long-term aging of their population. Retirees may feel they have done their duty by supporting school finance in their child-raising years. Seeing few direct benefits to themselves, they may be reluctant to support additional spending to maintain minimal services, particularly if they have relocated. Some school districts have experienced rapid population growth (often resulting from immigration to the United States). A "normal" financing effort might prove

to be inadequate to maintain minimal services when student enrollment ex-

pands rapidly.
Some states and local governments impose very tight borrowing restrictions and/or super-majority approval requirements for bond referenda that may frustrate the majority's spending preferences.

IN SUMMARY:

• The condition of America's school facilities may or may not be worse than the capital facilities for other state-local public services.

• The proportion of school bond votes approved rose from a low of 50 percent in 1991 to 67 percent in 1998. The percentage of dollars approved in 1998 was 82

percent versus 49 percent in 1991.

State-local taxpayers have devoted an increasing share of their own-source revenue to school bond finance; over the last twenty years, the volume of new-issue school bonds has grown at a 7.7 percent real annual rate, while state-local ownsource revenue has grown at a 4.1 percent real annual rate. Since the schoolage population has grown at a mere 0.2 percent rate, most of this spending has

been devoted to maintaining or improving facilities.

These data present a favorable picture for the Nation's school facilities, but may hide a subset of communities that find it difficult to maintain adequate school facilities due to: a high concentration of the poor; a concentration of retirees who are reluctant to support school spending; high population growth rates, sometimes resulting from an influx of immigrants; and very tight borrowing restrictions and/or super-majority requirements for approval of bond referenda.

TAX-EXEMPT BOND PROPOSALS

Several proposals have been introduced that would adjust the current tax treatment of state-local debt to increase federal financial support for school construction. (5) The Administration has proposed Tax Credits for Holders of Qualified School Modernization Bonds and Qualified Zone Academy Bonds; Representative Archer has proposed a lengthening of the period during which arbitrage can be earned and not rebated to the Treasury; Senator Graham has proposed allowing school facilities to be financial with proposed allowing school facilities to be financial with the formula with the formula with the financial with the formula with the formula with the financial with the formula with the financial with the formula with the financial support for school construction. cilities to be financed with private-activity bonds; and it has been proposed that the annual issuance ceiling to qualify for the small-issuer arbitrage rebate exemption be raised. The last two proposals were adopted by the Senate Finance Committee but not accepted by the Conference.

Each of these proposals is described. Each proposal's effect on the share of the debt service costs borne by state-local taxpayers is estimated, and the targeting of the proposal is compared to the targeting of federal on-budget spending for elemen-

tary and secondary education.

School Modernization Bonds.

Description. This Administration proposal would authorize issuance of \$11 billion of tax credit bonds in 2000 and \$11 billion in 2001. School bond volume in 1998 was about \$23 billion, so this proposal could be available to approximately 50 percent of the school bond market in 2000 and 2001.

Cost Reduction. Tax credit bonds pay 100 percent of state-local interest cost on bonds, as opposed to 25 to 30 percent of interest costs for traditional tax-exempt bonds. Thus, unlike tax-exempt bonds, tax credit bonds lower the cost of investing in school facilities relative to investing in capital facilities for any other public purpose. This lower relative cost would be a powerful incentive for state-local taxpayers to adjust their public budgets and provide more education services and less of all

Targeting. Half of the annual borrowing authority would be reserved for the Nation's communities with the highest incidence of children living in poverty. The remaining half would be allocated to the states and qualifying school districts based upon the federal assistance they received under the Basic Grant Formula for Title I of the Elementary and Secondary Education Act of 1965 (based primarily upon incidence of low-income children). But states would not be constrained by the Title I formula and could use any appropriate mechanism for distributing the funds. Thus, half of the subsidy would conform to the federal government's existing criteria for federal spending programs in education, and half could potentially be spent on other school districts.

Reluxation of Arbitrage Restrictions.

Description. State-local arbitrage bonds are tax-exempt bonds issued where all or a major portion of the proceeds are used to acquire securities with a higher yield. Because state-local governments pay no federal income tax on their interest earnings, Congress has restricted their ability to earn arbitrage profits. Bonds for construction are allowed to earn arbitrage profits if they conform to a schedule for spending the bond proceeds: 10% within 18x months of issuance; 45% within 12 months of issuance; 75% within 18 months of issuance; 95% within 24 months of issuance; and the permissible 5% retainage (amounts by which the earlier targets are missed) within 36 months. Failure to comply triggers a requirement to rebate the arbitrage earnings to the U.S. Treasury.

This proposal would slow and lengthen the spend-down schedule that must be met for bonds issued to finance public school education facilities in order to qualify for exemption from arbitrage rebate. No rebate would be required if: 10 percent of bond proceeds is spent within 1 year of issuance; 30 percent is spent within 2 years; 50 percent is spent within 3 years; and 95 percent is spent within 4 years. The 5 percent retainage would have to be spent within 5 years. The proposal applies to all

school bonds.

Cost reduction. Issuers must be cautious when attempting to earn arbitrage profits. Suppose the interest rate on the tax-exempt bond issue is 6 percent and the interest rate on a comparable long-term taxable bond is 8 percent. In theory, the issuer could earn 2 percent arbitrage profit by investing the tax-exempt bond proceeds in 8 percent long-term taxable securities. This is a risky investment strategy. The issuer's investment horizon is short because the spend-down rules require sale of all the securities within 36 months (60 months if this proposal is passed). Should interest rates have risen when the issuer must sell the taxable bond to pay for construction costs, the bond must be sold at a discount and the issuer will suffer a capital loss that could easily exceed the arbitrage earnings. Thus, the calculations in this testimony assume the issuer earns arbitrage profits of 0.75 percent, not the 2 percent yield differential. The important point here is not so much the share of the principal that could be paid off by the arbitrage profits, but the differential between current law and the proposed changes.

Assuming the issuer takes maximum advantage of arbitrage opportunities with a 0.75 percent profit, current law could provide arbitrage profits for tax-exempt bonds sufficient to pay for 1.05 percent of the amount borrowed. For tax credit bonds, this percentage would rise to 9.5.(6) Allowing a five-year spend-down period for tax-exempt bonds would increase the percentage borrowed that could be financed with arbitrage profits from 1.05 to 2.4 percent. If combined with tax credit bonds, the percentage would rise from 9.5 to 21.2 percent.

Targeting. The arbitrage proposal would apply to all school bonds. No attempt is made to target its availability to school districts that meet the federal government's

targeting criteria for its on-budget spending programs.

Public School Construction Partnership Act.

Description. This proposal introduced by Senator Graham in the 105th Congress would include public elementary and secondary education facilities in the list of exempt facilities eligible for the use of tax-exempt private-activity bonds. A state could issue bonds equal to the greater of \$10 per resident or \$5 million on behalf of corporations that would use the bond proceeds to build school facilities and lease the buildings to school districts. A corporation must charge a lease payment such that the building could be transferred to the school district at the end of the contract without further compensation to the corporation. The bonds would not be subject to the private-activity bond volume cap, so they would not compete with other privateactivity bonds for scarce borrowing authority.

Cost reduction. This proposal might reduce the federal subsidy. Private activity education facility bonds would be issued as revenue bonds whose debt service is secured by the corporation building and operating the facility rather than as general obligation bonds whose debt service is secured by the full faith and credit of the issuing school district. As a result, the interest rate on the private-activity school bonds is likely to be higher and the spread between the tayable interest rate and bonds is likely to be higher and the spread between the taxable interest rate and the interest rate on the school bonds is likely to be lower. The federal government would pay a smaller share of interest costs than it would pay on governmental taxexempt school bonds.

A school district that chose this option could conceivably receive compensation sufficient to offset its higher interest cost in two ways. First, it might face very restrictive bond referenda requirements that preclude getting approval from the voters. Although private-activity bonds require the issuing jurisdiction to hold a public meeting, they do not require a vote. Second, the corporation might be a more efficient builder and operator of the facility, or it may be able to avoid compliance with a host of regulatory rules pertaining to government construction projects (such as the Davis-Bacon Act). These savings might enable the corporation to provide lease terms whose present discounted value is lower than would be the case for principal and interest payments on the debt. (7)

Targeting. All but \$5 million must be allocated to high-growth school districts, defined as having: (1) a 5,000 or greater student enrollment in the second academic year preceding the date of the bond issuance; and (2) an increase in student enrollment of at least 20 percent in the 5-year period ending with that second academic year. It is not clear how many of the eligible districts would have characteristics

that are targeted by federal on-budget education spending.

Small Issuer Arbitrage Exemption.

Description. When the requirement for rebate of arbitrage earnings was enacted in 1986, governmental units that issued no more than \$5 million of bonds per year were exempt. In 1997, the exemption limit was increased to \$10 million, provided at least \$5 million is used to finance public school construction. This proposal would increase the exemption limit to \$15 million, provided at least \$10 million is used

to finance public school construction.

Cost reduction. The value of the small-issuer exemption is that the spend-down rules do not apply; the issuer can earn arbitrage profits on the amount borrowed for the entire three-year spend-down period. When considering a \$5 million marginal investment on a variety of public functions, state-local taxpayers will likely notice that (under current law) school bonds could earn arbitrage profits sufficient to pay 2.3 percent of the amount borrowed, while bonds for other functions could earn arbitrage profits sufficient to pay only 1.05 percent of the amount borrowed. If tax credit bonds could be combined with the small-issuer exception (while retaining the three-year spend-down requirement), arbitrage profits would be sufficient to pay 20.3 percent of the amount borrowed.

Targeting. This provision would apply only to relatively small governmental units. It is not clear how many of these units would have the characteristics that are tar-

geted by federal on-budget education spending.

ENDNOTES

(1) U.S. Library of Congress, Congressional Research Service, Public School Expenditure Disparities: Size, Sources, and Debates over Their Significance, No. 96-51 EPW by Wayne Riddle and Liane White, December 19, 1995, 31p.

(2) Indirect financial support is also provided by the deductibility of state-local income and property taxes from federal taxable income. This provision is not discussed here. The tax-exempt bond revenue estimate is based on a 1996 federal revenue loss from all outstanding bonds of \$25 billion (Budget of the U.S. Government, Analytical Perspectives, Fiscal Year 1998), and assumes the school share of the outstanding stock of all state-local bonds is equal to the school share (14.7 percent) of new-issue state-local bonds issued in 1996. A small amount of tax credit bonds are also available for school districts with high concentrations of students receiving free lunch. centrations of students receiving free lunch.

(3) U.S. General Accounting Office, School Facilities: America's Schools Not Designed or Equipped for 21st Century, GAO/HEHS-95-95, April 4, 1995; and GAO, School Facilities: Condition of America's Schools, GAO/HEHS-95-61, Feb-

ruary 1, 1995.

(4) For an example, see Commission to Promote Investment in America's Infrastructure, Financing the Future: Report of the Commission to Promote Investment in America's Infrastructure, February 1993. (5) The question of whether these proposed increased federal subsidies represent an improvement in economic efficiency is complex. The answer depends in part upon the extent to which returns from elementary and secondary education accrue to society rather than the individual and how widely these "external" benefits spill beyond state borders.

(6) Since the federal government pays 100 percent of the interest cost on tax credit bonds, arbitrage earnings would be 6.75 percent, not the 0.75 percent for tax-exempt bonds.

(7) Some have suggested the efficiencies in such public/private partnerships may be sufficiently great that school districts could reduce costs even if they used taxable debt. Ronald D. Utt, How Public-Private Partnerships Can Facilitate Public School Construction, Heritage Foundation Backgrounder No. 1257, February 25,

COMMUNICATIONS

STATEMENT OF THE BOND MARKET ASSOCIATION

The Bond Market Association appreciates the opportunity to submit for the record this statement on tax incentives for public school construction and rehabilitation. The Bond Market Association represents approximately 200 securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally

One-third of all elementary and secondary public schools, serving more than 14 million students, need extensive repair or renovation of one or more buildings, according to the General Accounting Office. Nearly all the responsibility for financing public school construction and rehabilitation has been borne by state and especially

local governments. However, the severity of the current condition of our public schools suggests that federal attention regarding school construction is now warranted. We commend Chairman Roth for calling this hearing.

Members of The Bond Market Association participate in school construction financing by assisting school districts in selling bonds to raise capital for school construction. Municipal bonds currently finance approximately 90 percent of all state and local investment in public schools. However, several federal tax code restrictions on the issuance and use of municipal bonds prevent school districts from using bonds to their full potential to finance school construction and rehabilitation. In its FY 2000 budget, the Clinton administration has proposed policy initiatives significantly expanding the use of "tax credit bonds." Under this new financing structure, states and localities would be able to issue qualified debt securities for targeted projects, including the construction and rehabilitation of public primary and secondary school facilities. Investors in the bonds earn federal income tax credits, presumably in lieu of interest payments by the issuers. Although this proposal is laudable in that it is designed to help school districts access the capital market to finance school construction, our initial analysis suggests that tax credit bonds would not provide school districts with no-cost capital as it is intended to do.

QUALIFIED ZONE ACADEMY BONDS.

In 1997, Congress passed and the President signed H.R. 2014 (P.L. 105-34), a budget reconciliation bill which included the Taxpayer Relief Act of 1997. Section 226 of the bill provides tax credits for holders of "Qualified Zone Academy Bonds" (QZABs). QZABs are bonds which may be issued by state and local governments to finance rehabilitation projects for public primary and secondary schools located in empowerment zones or enterprise communities or where at least 35 percent of students qualify for subsidized lunches under the National School Lunch Act. QZABs represent the first use of "tax credit bonds" to provide assistance for a designated public policy goal.

Although the goals of the QZAB program are laudable, the structure of the QZAB provision has seriously hindered its usefulness to school districts. Although some problems with the program are inherent in the tax credit bond structure, there are

several notable problems with QZABs in particular.

The program is very small. The Taxpayer Relief Act authorized only \$400 million of QZAB issuance per year for two years. This \$400 million amount is allocated among all the states, so any one state receives a relatively small allocation. In 1999, for example, the District of Columbia is permitted to issue a total of only \$1.2 million of QZABs. The small size and short term of the program results in several problems. First, it is difficult for bond issuers, attorneys, underwriters, investors and others associated with capital market transactions to commit resources to developing expertise on a new and unknown financing vehicle when very little issuance will be permitted to take place. Second, the small issuance volume ensures that there will be no significant secondary market for QZABs. A lack of market liquidity dis-

courages investors and raises costs for issuers.

The program requires "private business contributions." In order to qualify for QZAB financing, a school district must secure a "private business contribution" to the project being financed. The contribution must comprise at least 10 percent of the proceeds of the QZAB issue. The contribution can take the form of property or services. In practice, it has been prohibitively difficult for school districts to secure private business contributions needed to qualify for QZAB financing.

private business contributions needed to qualify for QZAB financing. The credit rate is reset monthly. The tax credit rate-the rate that determines the amount of tax credit earned by holders of QZABs-is set by the Treasury department monthly. This reset period is too infrequent to allow for efficient pricing and issuance of QZABs. Market interest rates change daily, even hourly, so a monthly reset period virtually ensures that the current credit will bear little relation to current market yields. Moreover, the credit rate is set at 110 percent of the "applicable federal rate" (AFR). This rate, however, does not necessarily reflect the actual rate of return that investors would demand in order to buy QZABs at a price that would leave the issuer with a no-cost source of capital.

leave the issuer with a no-cost source of capital.

Investors are limited. Only three classes of investors are permitted to earn federal income tax credits by holding QZABs, banks, insurance companies and "corporations actively engaged in the business of lending money." Individual investors, a potentially strong source of demand for tax-preferred investments, are excluded as QZAB

investors.

New construction is not eligible. The QZAB program provides assistance only for the rehabilitation of existing school facilities. Construction of new schools is not eligible for QZAB financing. School districts whose capital investment plans include primarily the construction of new schools are not helped significantly by the pro-

gram.

These problems, along with other issues related to tax credit bonds generally (see below), have crippled-the QZAB program. To date, only two QZAB transactions have taken place, totaling just \$26 million. Moreover, both issues sold at a discounted price. In other words, in neither case did the school district receive a zero-percent interest rate, as the QZAB program is intended to provide. In both cases, issuers had to offer significant original issue discount, in addition to the federal tax credits, in order to attract investors.

THE ADMINISTRATION'S BUDGET

In its FY200 budget, the administration has proposed a significant expansion of tax credit bonds for school construction and rehabilitation and environmental purposes. First, in recognition of the severe limitation that the "private business contribution" imposes on the QZAB program, the administration has proposed a tax credit for corporations that provide contributions to qualified zone academies located in empowerment zones and enterprise communities equal to 50 percent of the value of the contribution. Each empowerment zone would be able to allocate \$4 million in credits and each enterprise community would be allowed to designate \$2 million of credits. This proposal may make it easier to attract private business contributions for QZAB-financed projects.

Second, the administration has proposed expanding the QZAB program. Under the administration's proposal, eligible school districts could issue \$1 billion of QZABs in 2000 and \$1.4 billion in 2001. The program would be expanded to include school construction as well as rehabilitation. Eligibility requirements for QZAB projects, including the private business contribution, would remain the same. The QZAB structure would be changed to bring it into line with other proposed tax cred-

it bond programs. (See below.)

Third, the administration has proposed a new tax credit bond program for school construction and renovation, Qualified School Modernization Bonds (QSMBs). Although the QSMB proposal attempts to remedy some of the problems with QZABs, it would also impose a new requirement on school districts that does not apply under the QZAB program. The administration's proposal stipulates that the U.S. Department of Education would be required to approve the school modernization

plan of any state or school district that used QSMBs.

The QZAB program provides a simple allocation formula based on state populations of individuals living below the poverty line. The proposed QSMB program, although much larger than the QZAB program, imposes more stringent allocations. The administration proposes \$11 billion of QSMB issuance per year in 2000 and 2001. Half of this volume would be allocated to the 100 school districts with the largest number of children living below poverty. The Department of Education would also be able to designate an additional 25 school districts which "are in par-

ticular need of assistance." The other half would be allocated among the states based on funding currently received under the Department of Education's Title I grant program. Other allocations would be reserved for U.S. possessions and for schools funded by the Bureau of Indian Affairs.

THE PROPOSED NEW STRUCTURE FOR TAX CREDIT BONDS

In its FY 2000 budget, the administration proposes a new structure for all tax credit bonds. This new structure would apply to QZABs issued after December 31, 1999, QSMBs and the administration's proposed Better America Bonds, tax credit bonds for greenspace preservation, brownfield remediation and several other targeted environmental uses. In general, the structure is designed so that investors would buy tax credit bonds at face value-with no original issue discount-and with no pledge of interest payments by the issuer. If it works as designed, all of an investor's return would be earned in the form of the tax credit. The issuer is supposed to receive a zero-percent cost of capital.

Under the proposal, any taxpayer could claim a credit associated with holding a tax credit bond. Bondholders would become eligible to claim the credit annually on the anniversary date of a bond's issuance. Tax credits would be treated as taxable interest and would be included in a taxpayer's gross income calculation. The maximum term of a tax credit bond would be 15 years. Credits would be non-refundable, but could be carried forward for up to five years. The credit rate would be set daily rather than monthly, as under the current QZAB program. The credit rate would be based on prevailing market yields in the corporate bond market. An issuer selling tax credit bonds would use the tax credit rate published by the Treasury Department on the day prior to the day the bonds are sold.

TAX CREDIT BONDS AND THE CAPITAL MARKETS

Although the administration's proposed new structure for tax credit bonds is a vast improvement over the structure used in the current QZAB program, there are flaws inherent in any tax credit bond which would result in significant inefficiencies. Perhaps the most significant involves the timing of tax credits and the nature of

the investment return sought by bond investors.

With a traditional bond that pays cash interest, the yield calculation used by investors to price the value of a bond assumes that investors will receive interest payments according to a specified schedule and that investors will have the opportunity to reinvest those payments immediately. In the standard yield or price calculation, there is no time when any portion of an investor's return is not generating income. In contrast, the value of a tax credit under any of the proposed tax credit bond proposals is largely dependent on timing and on the tax situation of a particular investor. Under the administration's proposal, an investor earns the ability to take an annual credit on the anniversary date of a bond's issuance. However, the credit becomes economically valuable to the investor only when it has the effect of reducing a tax payment, and that occurs only on a day when an investor is required to make a federal tax payment. For some investors, tax payment dates occur only once per year. In the likely occurrence that the anniversary date does not coincide with a tax payment date, the investor incurs a period of time when the credit has no significant economic value. Because no money has changed hands, it is not possible for the investor to "reinvest" the credit as he or she could with a cash interest payment. The investor loses the reinvestment income that normally begins accruing on an interest payment date.

The situation worsens in years when a tax credit bond investor has no tax liability whatsoever. Under the administration's proposal, tax credits may be carried forward for up to five years. However, if an investor has no tax liability in a given year and is forced to carry the credit forward, the period of time during which the credit provides no economic value is extended even further. Again, until an investor is able to earn true economic value from the credit through a reduction in a tax payment, the reinvestment potential normally associated with interest payments is lost. This substantially erodes the value of the investment. These timing problems make it exceedingly difficult to efficiently price the value of a tax credit bond and introduces inefficiencies to the structure. Indeed, the value of the bond differs from investor to investor, depending on their tax circumstances. A second problem associated with the tax credit bond proposal involves the overall size of the program. The overall volume of tax credit bond issuance would increase substantially under the administration's various proposals. Taken together, the QZAB, QSMB and Better America Bond proposals would authorize the issuance of nearly \$29 billion of tax credit bonds over five years. In the context of the capital markets overall, however, that is a relatively small volume of issuance, especially given the novelty of the fi-

nancing structure. In contrast, in 1998 alone, states and localities issued \$286 billion of traditional municipal bonds. The relatively small size of the tax credit bond market would ensure that little secondary market trading took place. Tax credit bonds would be illiquid instruments. As a result, investors would demand a liquidity

premium-a higher rate of return-from bond issuers.

A third problem with tax credit bonds relates to the timing and value of the credit rate. The administration has proposed to set the credit rate on a daily basis using prevailing market yields in the corporate bond market. Tax credit bond issuers would use the previous day's credit rate when pricing and selling their bonds. Market interest rates change from day to day and even from minute to minute, however. It is highly unlikely that the interest rates used on Monday to set the credit rate would still prevail on Tuesday, when an issuer came to market with a bond issue. If rates have risen, issuers would have to make up the difference by offering a dis-

counted price on their bonds.

Market professionals have also expressed concerns about the credit rate itself and the attractiveness to investors of tax credit bonds with credit rates based on corporate bond yields. Because they would be priced and sold to investors based on corporate bond rates of return, they would compete for capital with corporate bonds themselves and similar taxable investments. However, because they are tax-preferred investments, tax credit bonds would be of little value to tax-exempt or taxdeferred investors such as pension funds, retirement accounts and foreigners, groups of investors which are very active in the U.S. taxable bond markets. The only investor groups to whom tax-credit bonds would be attractive are domestic individuals and corporations, largely banks and insurance companies, since they are most

active in the capital markets as investors.

For individual investors, tax-credit bonds would compete with tax-exempt municipal bonds and taxable corporate bonds. For many individual investors, municipal bonds provide a more attractive after-tax rate of return than corporate and similar taxable bonds. This stands whether the taxable investment pays cash interest or offers a tax credit at a rate based on prevailing corporate bond rates of return. It is unlikely that investors for whom tax-exempt municipal bonds provide a superior after-tax rate of return to corporate bonds would be attracted to tax credit bonds with yields based on the corporate market. Banks and insurance companies, who are active in the corporate bond market, would potentially find the credit rate appealing. However, the timing issues outlined above would make tax credit bonds with interest rates based on corporate bond yields less attractive than corporate bonds themselves. In short, it is likely that the pool of potential investors in tax credit bonds would be severely limited, given that tax-credit bonds would compete against corporate bonds themselves and similar taxable investments.

A fourth and final problem associated with the administration's proposals involves the degree to which federal agencies are required to approve projects before they qualify for tax credit bond financing. This approach runs counter to the flexibility and freedom enjoyed by states and localities in planning, financing and executing their construction projects. It is virtually unheard of for a local school district to seek federal approval before proceeding with a construction project. Injecting a high degree of federal control in the financing process would discourage school districts

from taking advantage of the tax credit bond programs.

In sum, given the problems associated with tax credit bonds outlined above, it is highly unlikely that any school district would in the end enjoy a zero-percent cost of capital through a tax credit bond. Given the inefficiencies built into the tax credit bond structure, school districts would invariably be forced to sell bonds at a discount to attract investor interest.

AN ALTERNATIVE-TAX-EXEMPT FINANCING

As stated above, tax-exempt bonds are the single most important source of financing for state and local investment in public school infrastructure. Tax-exempt bonds are efficient, well-understood, popular among investors, and have an established market infrastructure with a several-hundred-year history beginning in colonial times. Moreover, tax-exempt bonds provide an important source of federal assistance from the federal government to states and localities. Because the federal government foregoes the tax revenue on interest earned by investors on qualified municipal bonds, investors demand a much lower rate of interest than they otherwise would. States and localities benefit through a lower cost of capital.

Tax-exempt bonds are not plagued by any of the problems that would affect the success of tax credit bonds. Because they pay cash interest, municipal bonds are not affected by the timing issues that would erode the value of tax credit bonds. Because it is a large and established market with a broad base of investors, secondary market trading relatively is active and liquid. Interest rates are set efficiently according to market-based rates of return, and issuers do not need any form of federal ap-

proval to tap the capital markets.

As beneficial as tax-exempt bonds are in helping school districts finance construction and rehabilitation, the federal tax code contains a number of restrictions on the issuance and use of tax-exempt bonds prevent school districts from using municipal bonds to their full potential. Congress has considered and is considering several targeted changes to improve the ability of school districts to use tax-exempt bonds to finance school construction. These proposals would address restrictions related to private use, arbitrage, refinancings and limitations on purchases of tax-exempt bonds by certain investors. They would provide meaningful assistance to school districts by lowering the cost of financing for school construction projects. They would result in more schools being built and repaired and would, in some cases, accelerate construction projects that are on school districts' capital investment plans.

THE GRAHAM-GRASSLEY BILL

On March 3, Sen. Bob Graham, together with Sen. Charles Grassley and several other cosponsors, introduced S. 526, the Public School Construction Partnership Act. S. 526 epitomizes a serious approach to providing meaningful assistance to school districts faced with overwhelming construction needs. The Graham-Grassley bill would address several tax code restrictions on the use of municipal bonds for school construction and in doing so would leverage existing market mechanisms to give school districts tools to build more schools faster than they otherwise could. S. 526

would accomplish three things.

First, it would permit school districts to partner with private companies in financing and building new schools by including schools in the list of facilities eligible for "private-activity" bond financing. Nearly all other forms of infrastructure are already permitted to be built using public-private partnerships, and it is only natural to include schools on this list. Second, the bill would expand two existing exceptions to the arbitrage rebate rules for school bonds. Compliance with the complex and superfluous arbitrage rebate is costly and cumbersome, especially for small school districts. This provision would give school districts considerably more flexibility in planning and implementing school construction financing plans. Third, the bill would significantly expand the market for bonds issued by small school districts by increasing the universe of school bonds which may be bought by commercial banks. Banks can be a ready source of capital for school construction, and this proposal would permit banks to buy school bonds which are essentially not permitted under current tax law. This proposal would directly reduce the cost of financing for small school districts.

The Bond Market Association fully supports S. 526, and we urge Congress to act

on it quickly.

Providing assistance for new school construction is appropriately near the top of this year's congressional agenda. Unfortunately, the administration's tax credit bond proposal, although well-intentioned, would not provide the level of assistance it intends. Municipal bonds can and should be part of whatever solution Congress devises. The Graham-Grassley bill takes such an approach, and it has our full support.

We appreciate the opportunity to present our statement, and we look forward to working with members of this Committee and the budget process moves forward.

STATEMENT OF THE SECTION 127 COALITION

The Section 127 Coalition is a diverse group of business, labor, and education organizations that are committed to making the exclusion for undergraduate- and graduate-level employer-provided educational assistance found in section 127 a permanent part of the tax code. The Coalition appreciates the opportunity to submit this written statement as the Senate Finance Committee considers several education-related tax provisions.

Section 127 allows workers to exclude up to \$5,250 a year in reimbursements or direct payments for tuition, fees, and books for certain courses. The most recent extension of section 127 occurred in the Taxpayer Relief Act of 1997 (Public Law 105-34). That legislation extended section 127 through May 31, 2000. An extension for graduate-level courses was not included in the Taxpayer Relief Act. As a result, since July 1, 1996, educational assistance for graduate-level courses is taxable.

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Section 127 legislation has been introduced in both the House and Senate in the 106th Congress. Senators Daniel Patrick Moynihan (D-NY) and Finance Committee Chairman William Roth (R-DE) introduced S. 211 on January 19, 1999. On that same day in the House, Representatives Sander Levin (D-MI) and Clay Shaw (R-

FL) introduced H.R. 323. Both bills enjoys broad bipartisan support. H.R. 323 has over 85 cosponsors, and S. 211 has over 20. These companion bills would make section 127 a permanent part of the tax code for both graduate and undergraduate course work. President Clinton's Fiscal Year 2000 budget proposal to Congress also contains an extension of section 127 for eighteen months for both undergraduate

and graduate courses.

Congressional action making section 127 a permanent part of the tax code would remove the uncertainty and ambiguity that employees and employers now regularly face, and would be consistent with the intent of Congress when the provision was first enacted in 1978. At that time, supporters of employer-provided educational assistance hoped that the enactment of the provision would meet three broad goals: (1) reduce the complexity of the tax code; (2) reduce possible inequities among tax-payers; and (3) remove disincentives to upward mobility. Several studies have been conducted on section 127 reviewing the application, use, and effectiveness of the benefits. The two most recent studies on employer-provided educational assistance include a 1995 study conducted by the National Association of Independent Colleges and Universities (NAICU), entitled "Who Benefits from Section 127," and a Government Accounting Office (GAO) study completed in December of 1996 entitled, "Tax Expenditures: Information on Employer-Provided Educational Assistance" (GAO) GGD-97-28). Review of the information contained in these studies clearly demonstrates that the provision is meeting the original intent of Congress.

The permanent extension of section 127 would reduce the complexity of the tax code. Prior to 1978, only educational assistance provided by an employer to an employee that related to the individual's job was excluded from an employee's gross taxable income (sections 62 and 132 of the Internal Revenue Code). The "job-related" test contained in Treasury Regulation 1.162-5 was confusing to both employers and employees and resulted in both the Internal Revenue Service and the courts making arbitrary decisions as to what type of employer provided educational assistance successfully met the test of job-relatedness. Unlike other code sections that govern educational assistance, section 127 does not require either an employer or employee to make a distinction between job-related and non-job related educational assistance in order for the employee to receive the assistance. Section 127 therefore ensures that administrative complexity is reduced and clarity is achieved for both

the employer and employee.

If Congress fails to make section 127 permanent, employers and employees will be continuously faced with the difficult task of determining whether educational assistance meets the "job-relatedness" test. As a result, the balance and equity among taxpayers that has been established through section 127 would be eliminated and the opportunities for less-educated and skilled employees to improve their skills

with additional training would be restricted significantly.

A permanent extension of section 127 reduces possible inequities among taxpayers. This goal was especially important to Congressional sponsors of section 127. Under the job-related test of sections 62 and 132, most entry-level employees are unable to claim an exclusion for an educational expense because their job descriptions and responsibilities are not broad enough to meet the test. In effect, only highly skilled individuals are able to use job-related educational assistance. The goal of section 127 is to allow employees in lower-skilled positions the opportunity to receive educational assistance from their employer and for these individuals to utilize the benefit without the worry of the job-related test. According to the NAICU study, 43.6% of section 127 beneficiaries were in clerical or secretarial positions.

Like any other benefit, employers are not required to provide section 127 benefits to their employees. If an employer chooses to provide educational assistance benefits to its employees, the employer must offer the benefits to all employees on a non-discriminatory basis that does not favor the highly compensated. This requirement, together with information from various studies, indicates that lower-skilled individ-uals are utilizing the benefit at a greater rate than those in more skill-intensive pro-

A permanent extension of section 127 removes disincentives to upward mobility. While section 127 provides the opportunity for individuals to advance, it does not guarantee it. Recipients of section 127 are not traditional students: they are working, most of them in a full-time capacity. They choose to return to school on a parttime basis to improve their skills and educational qualifications. Without their employer's assistance, many of these individuals would not be able to pay for the education themselves. Each time the provision expires and employers begin to withhold taxes on the benefit, individuals relying on section 127 discontinue or scale back their undergraduate and graduate educational pursuits because they cannot afford to even pay the taxes on the benefit. According to the NAICU study, 33 percent of section 127 recipients were pursuing associate degrees, 23 percent were in bachelor's

degree programs, and 13 percent were enrolled in programs that awarded undergraduate educational certificates. About 25 percent of the recipients were in master's degree programs or in "other graduate" programs—primarily graduate certificate programs. The number of students in doctoral (Ph.D., Ed.D., etc.) or professional (J.D., M.D., etc.) programs was too low to be measured. According to this same study, nearly 85 percent of section 127 recipients earned less than \$50,000 and 50 percent of the recipients earned less than \$32,000. Clearly those who section 127 was intended to benefit are using this opportunity to upgrade their skills, keep current in this rapidly changing technological environment, and potentially advance within their organization. Restoring graduate course eligibility will also decrease the complexity of some section 127 benefits being taxable while others are not.

As Congress debates the role of the federal government in education, there are some important points to consider when contemplating a permanent extension of

section 127:

Section 127 is Not a Government Program—This is a purely private sector initiative and the most significant provision encouraging employer investment in their worker's continuing education. There is no large bureaucracy to administer the program. In fact, 100 percent of every dollar spent by the employer goes toward the education of the employee. Like any other benefit, employers are not required to provide section 127 benefits to their employees. Nevertheless, employers provide these benefits to their employees because they see value and a return on the investment in their employees' education. Employees use section 127 benefits to keep current with changing trends in rapidly advancing fields as well as to improve basic skills.

Section 127 Encourages Business Support and Partnership of Education Initiatives—This provision is a good proposal for employers and employees alike, encouraging partnerships between a company and its individual employees. Companies see section 127 benefits as a prudent and an economically sound investment in its workforce because they receive, in return, a better educated and more technically skilled worker. Employees view section 127 as a way to improve their work skills and advance up the ladder of success. These benefits also provide companies with additional flexibility for reorganization efforts which may be necessary, since educational assistance may be offered through an outreach program to their laid-off workers or be used to retrain employees for other positions.

The Coalition applauds the bipartisan efforts to make section 127 permanent. The Taxpayer Relief Act of 1997 reinstated section 127 once again—the ninth time that the provision has been extended since it was first enacted as part of the Revenue Act of 1978. The on-again, off-again extension of section 127—as well as the current absence of coverage for graduate work—causes uncertainty in the tax code, creates administrative difficulties for employers, corrodes our system of voluntary compliance with the tax laws, and leaves employees with unanticipated tax liabilities.

The continued education and development of the U.S. worker are fundamental to meeting the challenges of the international marketplace. The Coalition urges Congress to make a commitment to the continuing education of our work force by reinstating the exclusion for graduate courses and making section 127 permanent.

Thank you for this opportunity to express our support for the permanent exten-

sion of section 127.

THE SECTION 127 COALITION

American Council on Education American Electronics Association American Federation of State County and Municipal Employees American Federation of Teachers American Society for Payroll Management American Society for Training and Development American Society of Mechanical Engineers Association of American Universities Association of Community College Trustees Association of Private Pension and Welfare Plans Ceridian Corporation College and University Personnel Association Council for Adult and Experiential Learning Council of Graduate Schools International Personnel Management Association Johns Hopkins University Marymount University National Association of College and University Business Officers National Association of Independent Colleges and Universities National Association of Manufacturers National Society of Professional Engineers Raytheon Company United Auto Workers University of Michigan U.S. Chamber of Commerce