



Policy Paper

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Restoring Higher Education in America

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Section One: The Cost Crisis in Higher Ed

Addressing a \$1.4 Trillion Calamity

There can be no doubt that the higher education system in the United States is in a fiscal crisis. Student loan debt has skyrocketed as the price of college tuition for students has continued to outpace inflation. Since 1985, college tuition has grown by more than 500 percent – more than healthcare, gasoline, and food. Sixty-nine percent of 2014 graduates graduated with student loan debt.¹ The student loan default rate was 11.8 percent in 2015.²

As of 2017 more than 44 million Americans owe student debt, surpassing all other forms of consumer debt at more than \$1.4 trillion.³ The average graduate of the Class of 2016 has \$37,172 in debt – up six percent from the Class of 2015.⁴ It's no wonder: The College Board reports that tuition and fees for the 2016-2017 school year averaged \$9,650 for in-state residents and \$24,930 for out-of-state residents attending public 4-year institutions, and \$33,480 at private 4-year colleges – plus nearly \$11,000 in room and board costs.⁵ Unlike most consumer debt, student loan debt is extremely difficult – if not impossible – to discharge in bankruptcy.

Former Democratic presidential candidates Hillary Clinton and Bernie Sanders rightly focused much of their campaigns on this issue. On the campaign trail, both former Secretary of State Clinton and Senator Sanders contended that the key problem is the \$1.4 trillion that has been accumulated nationally in student loan debt. The solution, they argue, is to lessen the burden of that debt by capping the amount owed each year, decreasing or eliminating the interest rate, and to ultimately forgive the liability altogether.

Clinton and Sanders also offered plans to make college “more affordable.” While Clinton proposed offering free community college for all, Sanders produced a plan to offer four tuition-free years of public college or university altogether.

Their rationale for doing so seems to be part of a consensus on the benefits of higher education. Our government has understandably concluded that the ability to move forward economically and to prosper as a nation in the 21st century depends greatly upon the education of its people.

But the federal government already tries to “help make college more affordable” for the average American by devoting significant taxpayer resources to divvying out subsidized loans (which subsidize interest, such as the Federal Direct Loan) and grants, like the Pell Grant, and by effectively

nationalizing the student loan industry in Obamacare. Yet despite the huge uptick in financial aid available to students under the pretense of affordability, the price of college has continued to rise each year. Why is this?

Causes of the Cost Crisis

Dr. Richard K Vedder, Ph.D., Director of the Center for College Affordability and Productivity and a leading scholar in reforming higher education, has identified twelve key reasons for the sordid rise in college costs for students.

Chief among these is the fact that, as with the healthcare industry, “a large part of the bills in higher education are financed by third parties—neither the consumer nor the producer of collegiate services. The federal government, state governments, endowments, and private donations are important. When someone other than the user is paying the bills, those bills tend to explode since the buyer is not sensitive to price.”⁶

Indeed, college isn’t immune to market pressures just because it may be socially beneficial. Since supply is failing to keep pace with demand, the price of higher education has skyrocketed. While some may be discouraged from going to college because of the increased expense, the added influence of federal student aid well surpasses any potential disincentives. Meaning students are still attending college in record numbers, despite the constant tuition hikes.

This makes sense. If I’m separated from the cost and someone else is doing the paying, I’m going to feel empowered to buy more of it, whatever “it” is, as I’ve got less incentive to look for an alternative. After all, if someone else is paying for it, why should I care? And from the colleges’ perspective, with all the “free money” that just keeps pouring from the government spigot, why not jack up prices?

In a July 2015 report focusing on “Credit Supply and the Rise in College Tuition,” the Federal Reserve Bank of New York observed a direct correlation between students’ funding of their education through student loans and changes in student borrowing and tuition levels. As the Fed notes:

Higher tuition costs raise loan demand, but loan supply also affects equilibrium tuition costs—for example, by relaxing students’ funding constraints... We find that institutions more exposed to changes in the subsidized federal loan program increased their tuition disproportionately around these policy changes, with a sizable pass-through effect on tuition of about 65 percent.⁷

The “pass-through effect on tuition” refers to the phenomenon whereby, for every dollar received in subsidized federal loans (loans where the government subsidizes the interest), colleges increase their tuition by 65 cents.

The report also finds that Pell Grants on average boost tuition by 55 cents and unsubsidized loans (where government does not subsidize the interest) increase tuition by 30 cents on average.⁸ It seems that the more government does to pass out financial aid in order to “make college affordable,” the costlier it becomes.

As the New York Fed’s study reveals, the burden of student loans isn’t expanding because college is becoming more expensive. Rather, school is too expensive *because* of the growth of student loans and grants. So, if government aid to students hasn’t helped – and in fact has made college less affordable – what, then, should we be looking at?

Section Two: The New Millennium Plan for Higher Ed Reform

Reinvigorating Higher Education by Fixing a Broken System

What is really needed to lower the *cost* of higher education is *real reform* in higher education – reforms that address the central reasons college is so expensive, as well as the student loan crisis. The **New Millennium Plan for Higher Education Reform** would accomplish four primary objectives:

1. Fundamentally reform the federal financial aid system
2. Eliminate or restructure the academic accreditation system
3. Promote community colleges and trade schools at the state and federal levels
4. Replace the current funding system for state universities with a voucher system

Reforming the Federal Financial Aid System

The first step Congress must take when addressing higher education is to fundamentally reform the nation's failed federal financial aid system.

A Broken Financial Aid System. Our complex network of federal student aid programs has failed to accomplish its core objectives and to hold down costs. There are several key reasons underlying just how broken and in need of reform the financial aid system is.

First, this paper has already discussed how student loans, grants, and other financial aid programs significantly contribute to the skyrocketing prices of college education. This is by far the most pervasive factor necessitating change, as it affects individuals and families of virtually all income brackets, especially the poor.

Second, as Dr. Vedder, Christopher Denhart, and Joseph Hartge have noted, the original reason student-aid programs were created was to make college more accessible for those in lower income brackets. Yet this has been an abject failure, contributing to greater income inequality. Strikingly, “in 1970 the bottom quartile of families by income accounted for 12 percent of total bachelor’s degrees received by age 24, but those families only accounted for 9.4 percent in 2010.”⁹ This is in large part because federal student aid programs have pushed up the cost of college to the point where many low-income students can no longer afford to attend college.

In addition, higher ed institutions “have adjusted their need-based aid downward in favor of merit-based scholarships, given the existence of governmental programs like Pell Grants.”¹⁰ Finally, lower-income students have a higher dropout rate than those from families who are more affluent. This means that those students who do drop out have fewer economic opportunities before them, often while shouldering a relatively high debt burden—exacerbating income inequality.

Third, thanks to the *Affordable Care Act of 2010*, the federal government now controls the entire functioning of the student loan system. When a student takes out a loan for school, the college gets paid at the outset. Consequently, the student’s balance owed is to the government, not the school, and taxpayers are left on the hook for all the risk if students should default on the obligations. In other words, colleges have no skin in the game because they lack any risk; they are guaranteed taxpayer money no matter how high tuition is or who is attending the school.

The fourth issue centers on the Free Application for Federal Student Aid (FAFSA) form, which students are required to fill out in order to receive financial aid. The FAFSA is fundamentally flawed in two main ways, causing significant challenges for applicants to college.

- *It is intimidating to complete, especially for lower-income students.* The form has been historically and unnecessarily more than 100 questions long. They are extremely detailed, highly personal, and often-intimidating questions regarding family finances, including income, mortgage payments, family debts, checking account balances, stocks, and so forth. “[T]he form is so complex that it stops some from applying for aid or attending college, mostly deterring students from low-income backgrounds.”¹¹ This is particularly so for those who need student aid the most.
- *It provides inadequate information to applicants in an inadequate timeframe.* One of the biggest problems with the FAFSA is that filling out and submitting the form provides no useful information to applicants and their parents, especially regarding how they are going to be able to afford their education. “Even after completing a lengthy and often confusing application, the student and family have no more information on their ability to finance the student’s education than before the application was completed. In most cases, a student does not learn of the types or amounts of financial aid he or she is eligible to receive until notified by the postsecondary schools listed on the FAFSA.”¹² This makes it difficult, if not impossible, for students—especially low-income students—to make financially-sound decisions on which schools to apply to and ultimately which to select.

Fifth, price discrimination plays a critical role in spurring the high cost of postsecondary education by obscuring the real cost of a private college or university education from consumers. As Investopedia defines it, “Price discrimination is a pricing strategy that charges customers different prices for the same product or service. In pure price discrimination, the seller will charge each customer the maximum price that he or she is willing to pay.”¹³

Because the FAFSA form provides colleges and universities with exceptional amounts of intrusive, personal financial information, institutions of higher learning are easily able to engage in price discrimination. “For years, higher education has operated with a philosophy that if it costs more, it must be better or more valuable, and it must also be in short supply,” observes York College of Pennsylvania President George Waldner. He notes that “95% of all private institutions” set their sticker price at “an arbitrary number,” driving up tuition costs throughout the system:

Aid used to be distributed according to need alone. Those who required financial help got it. Now college financial aid budgets are used mainly for “merit-based” aid, which necessarily reduces the available pool of need-based aid. Expensive colleges, with asking prices already double and sometimes triple or quadruple the cost of state schools, start high and award all the merit-based aid they must to fill their seats with the students they want.¹⁴

Dramatic Reforms to the Financial Aid System. A fundamentally broken system requires dramatic reforms. There are five key steps which, phased in over a period of no more than 2-3 years, will remedy the flaws inherent in the student financial aid system and lower costs.

First, the duplicitous nature of our various student loan programs – Perkins, Federal Direct (subsidized and unsubsidized), and the PLUS loans – is unnecessarily complex. Congress should instead consolidate these student loan programs into two programs, one for students and one focused on parents. Congress should also reinstitute the option of private servicing of loans, as opposed to having the Department of Education as the exclusive lender, and establish academic performance standards and time limits on loans.

Over a three-year phase-in period, a new **Student Loan Program** should replace the Federal Perkins, Direct Subsidized, and Direct Unsubsidized Loans. The replacement program should offer two legs to it. First, each student should be eligible for up to \$7,500 on an annual basis, regardless of the school

they attend, and up to \$10,000 additional for those students who demonstrate particular financial need. Both loans will accrue interest at market rates.

The renovated **PLUS Loan Program** should serve a similar purpose and place greater limits on loan amounts than the current system. The PLUS loan should be available for parents with dependent children, offering up to \$3,000 for eligible parents and up to \$3,000 additional based on need metrics. The PLUS loan should also be available to students who are attending graduate school or who, while in their undergraduate program, are independent for tax purposes. The PLUS loan will accrue interest at market rates.

Under the *Bipartisan Student Loan Certainty Act of 2013*, interest rates are determined each spring for new loans being made for the upcoming award year, which runs from July 1 to the following June 30. Each loan has a fixed interest rate for the life of the loan. For both the Student Loan and the PLUS Loan programs, interest rates should be tied to the financial markets in a similar fashion.

Second, the new loan program should be coupled with an income-based repayment plan. Moreover, student loans are extremely difficult to discharge in bankruptcy. As the AccessLex Institute proposes, “education loans [should] be considered on equal terms with other unsecured debt in a bankruptcy proceeding if the loan in question has been in repayment for at least seven years (exclusive of deferments or mandatory forbearances).”¹⁵

Schools should also have some stake when a bankruptcy gets discharged, giving them added incentive to be responsible stakeholders in their students’ education. The institution would continue to get its money up front for each loan disbursed, but it immediately becomes, in effect, a co-signer on the loan. When the student defaults, the school should be liable for 5 percent of annual losses on the value of the loan.

In addition, borrowers should at any time have the option of consolidating and/or refinancing their loans with a private loan servicer at a negotiated interest rate (either fixed or variable).

Third, Congress must eliminate the complex system of tax credits and deductions, which contribute to the increases in the cost of tuition. There are currently three different tax benefits for higher education expenses: the **American Opportunity Tax Credit**, the **Lifetime Learning Credit**, and the **Deduction for Education Expenses**, which includes both the Tuition and Fees Deduction and the Student Loan Interest Deduction. Because taxpayers may claim only one of these educational tax benefits, they have to calculate their income, school expenses, and potential tax savings for each to determine which benefit will be greater.

Like the birth of other student aid programs, these tax credits were intended to help make it more possible for lower-income individuals to attend college. However, a 2006 working paper by the National Bureau of Economic Research, which analyzed the behavioral effects of such credits, concluded that the credits did not make it more likely that a student would attend college. Instead, those who primarily benefited from the program were found to be those who were already likely to go to college.¹⁶ Indeed, tuition tax credits “provide tax savings only if students attend college, increasing the demand for college and thus college prices, defeating some of the benefit of the tax credit.”¹⁷

Tax credits can provide a useful tool to help spur economic activity in a given direction, but their benefits must be weighed closely against their costs. Congress should at the very least consolidate the three higher education tax benefits into one, single tax credit, as Florida Senator Marco Rubio and

Congressman Aaron Schock of Illinois proposed. Their 2013 bill would establish the **Higher Education and Skills Obtainment Credit**, replacing the existing three programs.¹⁸ This bill is a step in the right direction.

And yet, given the costs to taxpayers, the failure of these tax credits to help constrain costs, and their apparent role in stimulating greater costs, it makes far more sense to eliminate all the higher education tax incentives altogether. Therefore, while there are advantages to at least consolidating tax benefits into one, single credit, it is preferable to do away with tax credits and deductions altogether.

Fourth, Congress should replace the Pell Grant with a voucher that subsidizes students, not institutions. The Pell Grant program provides aid to those who need it most, which is a veritable goal. However, in structuring the program such that Pell Grant money flows directly to and through postsecondary institutions, as it does now, schools are shielded from market incentives. What if we allowed market forces to work and instead put students in charge of their financial aid dollars?

The Pell Grant should be restructured into the **Pell Stipend (PS)**, which would offer a set amount for eligible students each term (trimester, semester, quarter) to receive directly via the federal government for the purposes of a higher education program. As part of the Stipend program, possible variability in the amount provided to a given student may be reasonable based on the region in which he or she is attending school. The amount offered should range from \$4,000 to \$6,000. Any increases in the stipend amount would be kept in parity with the rate of inflation and students will not receive extra voucher money based on the cost of the specific institution they choose to attend.

As a consequence of such a shift, institutions of higher learning would become more sensitive to the costs they impose on their students, potentially losing revenue streams unless they are able to keep up student enrollment for their income. The Stipend would also require that schools focus more on the quality of their programs to appeal to the greatest number of students and will put emphasis on improving academic performance, teaching, and instruction.

Fifth, the FAFSA should be abolished and replaced with a brief, simple, and straightforward form asking for basic information such as income, family size, age of children, and the like. The law should be changed so that verification of financial information is provided through the Internal Revenue Service, something which requires congressional action. The financial information provided in the form should not be provided to schools.

Immediately or soon after submission, students should be informed of the amount of aid they will receive, rather than how much they will be expected to pay and rather than having to wait until shortly before they apply to or leave for college to find out their aid amount. With a simplified federal student aid system and a greater emphasis on means-tested aid to help rein in college costs, as proposed above, a far more simplified, less intimidating, and more informative form will be an extremely helpful component to higher education reform.

Leveling the Playing Field

There are growing questions about the universal benefits of a traditional, four-year college education. Some may be better served by completing two years of community college, then finishing a four-year degree at a public university. For others, a trade school may be a better fit. Alternatively, a for-profit college or university might work best for a particular student's needs and interests.

Rather than discouraging students from these valuable options, Congress should encourage program equity at every level. As Senator Rubio wrote in 2015, "Our higher-education system should be

reformed to ensure that alternative education pathways are no longer stigmatized or discredited by the existing higher-education cartel.”¹⁹

Issues with Accreditation. It all starts with accreditation, the process by which colleges and universities are determined eligible for federal funding, including grants and loans. In the United States there are six member-based accrediting agencies, each of which were originally intended to “ensure that students attended quality institutions from which they were likely to graduate and be employable, thereby safeguarding students and ensuring taxpayer dollars were well spent.”²⁰

Former U.S. Senator Hank Brown, a past president of both the University of Colorado and the University of Northern Colorado, notes that these accrediting agencies are questionable in terms of their relevance and their practicality today:

They are regional monopolies that control access to federal funding for virtually every type of college and university in their geographic area—from private universities and community colleges to for-profit trade schools and nonprofit liberal arts colleges.

These regional accrediting agencies are membership organizations, meaning that the colleges and universities they oversee fund the accrediting body through dues and fees. While the regional accrediting agencies employ professional staffs to coordinate their activities, the bulk of the work is undertaken by hundreds of volunteer faculty and staff from the very institutions being accredited. In practice, the agencies charged by Congress with determining if a college is eligible to receive federal dollars are funded and staffed by the institutions whose quality they are supposed to ensure, a conflict of interest.²¹

These perverse incentives contribute to a system which limits competition for federal dollars to only those institutions that are accredited, stunts the competitiveness of innovative schools, and offers member institutions every incentive to shut out their nascent competitors. In short, the barrier to entry for higher ed institutions is set so high that it makes it difficult, if not impossible, for new institutions to get the accreditation they otherwise need to be competitive. The playing field needs to be leveled for all institutions.

Another problem with accreditation is that accrediting agencies generally use input measures rather than outcomes. Indeed, many universities have horrendous graduation rates, yet federal dollars can continue to make their way to schools that “graduate less than a quarter of their students in six years.” These include the University of the District of Columbia (7.7 percent graduation rate), Louisiana State University-Alexandria (11.1 percent), Texas Southern University (13.3 percent), and Chicago State University (13.9 percent).²²

The consequences of low graduation and high dropout rates to students who take out loans for school – those whom accreditation agencies are supposed to protect – can be catastrophic. In 2009, 29 percent of students who took out loans dropped out of school, demonstrating clearly that accrediting agencies simply do not enforce standards.²³ Instead, they let colleges enroll students who are sorely unqualified and unlikely to earn anything but mountains of debt.

Based on all the evidence, there is no question that reform to the accreditation system is needed. Even President Obama, Senator Rubio, and Senator Michael Bennet of Colorado agree. So, what do we do about it?

Reforming Accreditation. In an ideal world, the accreditation system would be eliminated altogether. After all, why do schools need to be accredited in the first place? Aren’t there other, more

transparent and effective ways to assess how successful higher ed institutions are at educating their students using outcome-based metrics?

Unfortunately, given the complex network of stakeholders involved in the accreditation process, eliminating accreditation altogether may prove politically infeasible. Alternatively, Congress should consider something along the lines of the *Higher Education Innovation Act*, introduced by Senators Bennet and Rubio in September of 2015, which would create a second “authorization pathway” to access federal aid, like Pell Grants and student loans.

Innovative schools that offer a high-quality education and have a proven track record of successfully helping students graduate, obtain jobs, and pay back their student loans could participate in this metrics-based authorization process in place of the burdensome input-focused accreditation process. The bill would also allow higher education providers that currently are ineligible to receive federal student aid to access federal financial aid if they demonstrate high student outcomes, including student learning, completion, and return on investment. Only schools that meet these high standards would be eligible for this authorization process...

...This bill creates an alternative outcomes-based process that would allow students to use their federal aid at new providers and existing colleges and universities that demonstrate successful student outcomes and offer innovative and effective programs.²⁴

Creating two pathways to access federal student aid is a starting point toward injecting substantive competition into the educational marketplace, something which is profoundly needed. Participating institutions should include any public, private, for-profit, non-profit, or trade school offering a postsecondary education that demonstrates solid, outcome-based achievement.

In the long run, however, it will surely prove counterproductive to have two, separate systems by which to judge an effective return on investment. Ultimately, Congress should phase into a single system in which institutions obtain, publish, and are rated based upon outcomes-based data such as “recent alumni satisfaction with their college experience, post-graduate vocational success (including earnings), the value added to critical thinking and writing skills while in college, etc.”²⁵ These ratings can be determined through private means or through the existing accreditation agencies.

Regardless, an outcome-based system that treats all institutions the same is essential in order to provide greater choice and opportunity that better meets students’ wants and needs.

Promoting Community Colleges and Trade Schools

The federal level is not the only place where reform of higher education needs to take place. In fact, many of the necessary reforms are institution-based, such as tenure reform and year-round schooling. There are also several steps states can take to help address the college cost conundrum and improve the quality of higher education.

Building on the above federal reforms, students should be encouraged to look to community colleges as an alternative to traditional, four-year college programs. States like Colorado, and the feds if they get involved, should focus on campaigns to spread awareness to students about how they can save large sums of money by completing their core requirements or their first two years at a community college before applying to a state or private university.

As a society, we should stop talking down community colleges and start praising them as rational, low-cost options for students to take personal responsibility for their own, quality education while taking out fewer loans or charging more to the federal credit card. This will require fundamental reforms to

the credit transfer system that enable more course credits to transfer from a community college to a four-year university.

The same rhetorical support should go for vocational schools. For years, students making their way through high school have been taught one, constant drumbeat: when you graduate, your next step is to go to college. And yet with remedial education and college dropout rates at stunning levels, clearly not every student is cut out for or best served by the traditional college education.

Why not encourage those who may be better suited to attend a trade school to pursue that option? Many graduates from vocational programs ultimately go on to earn significant incomes, more than justifying these options for students. There is no justifiable reason for treating trade schools differently from traditional colleges and universities, simply because of their subject matter.

Replacing the Current Funding System for State Universities

Promoting greater choice, competition, innovation, and opportunity for all students cannot happen exclusively at the federal level. It must take place at the state level as well.

To that end, it is important to note that public higher ed institutions like the University of Colorado, the University of Michigan, and the University of Virginia typically receive around 10 percent or less of their funding from their respective state governments.²⁶

With such a small percentage already in play, isn't it more sensible to alter the funding mechanisms in a systemic way? States should look at ways to transition their higher ed systems from a fee-for-service subsidy model, whereby the state directly funds public colleges and universities, to a more effective funding approach. What if the system emphasized student choice, while incentivizing state colleges and universities to be fiscally responsible?

Colorado, the state in which the Millennial Policy Center is headquartered, provides a partial blueprint for a series of state-based reforms that would contribute to reining in the price of college.

Colorado offers the College Opportunity Fund (COF) program, which grants a stipend to qualified residents paying in-state tuition at participating undergraduate institutions. A typical, eligible student at a community college or public college or university can currently receive a total of \$10,875 over four years; the amount is \$5,510 for a participating private college student at a small number of select private institutions. Some students may be eligible for a waiver offering additional funds for the 145-hour credit limit. No for-profit colleges or trade schools are included.

The COF stipend replaces much of the direct support for higher ed institutions that used to come from the state; however, subsidy mechanisms balance out financial support to ensure that total state funding at a given institution remains relatively unchanged. This shields colleges and universities from “[competing] for any students, let alone in-state students or underrepresented populations.”²⁷

States like Colorado should adopt an entirely stipend-based system, eliminating all direct subsidies for institutions. This will not be popular among the flagship university lobbies, but it is a necessary first step in promoting substantive competition for state dollars. Increased competition would compel colleges and universities to be more honest about their degrees—and which degrees are truly useful.

Second, the voucher would follow students to any qualified public, private, or for-profit college, university or trade school. It would be redeemable for up to four years of postsecondary education and would not apply to postgraduate education. Third, the stipend would attach an equal amount of

money to all students, regardless of institution, rather than giving different amounts based on private versus public status, or for-profit versus not-for-profit. This means equity among trade schools and private schools, as well as public universities and community colleges.

The current state model for higher education funding is not working. As public higher ed institutions confront continued revenue cuts, and other postsecondary options hold increased promise in today's 21st century economy, reforming states' higher education systems in such a way that will increase competition and stimulate lower costs in the long run makes sense.

Section Three: Injecting Real Opportunity into Higher Ed

Concluding Thoughts

The research is clear: The simplistic proposal presented by former Secretary of State Hillary Clinton and Senator Bernie Sanders that would forgive student loan debt and make college “free” might seem like a great idea on the surface. After all, access to free college education and dissipating the debt hanging over Millennials' shoulders would promote a more financially-sound life for graduates. However, what they are selling is a bill of goods.

Not only is it impractical for the federal government to forgive more than \$1.4 trillion in student loan debt, but it is also literally infeasible to provide free college for all. In fact, more third-party spending via such an expansive government program would only serve to exacerbate, not alleviate, the rising tide that is college costs. And the truth is, Millennials will eventually have to pick up the tab through payments on a federal debt that is already \$20 trillion.

Instead, Congress and the states should invest in market-based solutions for higher education. Any serious effort to constrain college costs must fundamentally reform the existing federal financial aid and postsecondary accreditation systems, promote community colleges and trade schools as viable educational options, and replace direct state subsidies for higher education with a stipend-based system similar to Colorado's College Opportunity Fund. By doing this, the door would open to lower costs for students and improved competition, choice, quality, and opportunity throughout the system.

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