Pay It Forward and Income-Contingent Repayment Funding Models for Higher Education

A higher education funding proposal known as "Pay It Forward" has emerged from Washington State and is now garnering attention in several other venues. The American Federation of Teachers and many of our affiliates have significant concerns about this model and urge caution to anyone considering this as an alternative funding mechanism for higher education.

Background: The Disinvestment Challenge and Educational Debt

There is, of course, no doubt that there is a crisis of funding for American public institutions of higher education.

- According to the annual State Higher Education Finance report for FY 2011, "educational appropriations per FTE (defined to include state and local support for general higher education operations) fell to $6,532 in 2010—a 25-year low in inflation-adjusted terms. It fell further to $6,290 in 2011[i].
- According to DEMOS, real funding per public full-time equivalent student dropped by 26.1 percent between 1990-91 and 2009-10[ii].

As a consequence, students at public institutions have seen their education costs skyrocket.

- In the last decade (2002-3 through 2012-13), published tuition and fees for in-state students at four-year public universities have increased at an average rate of 5.2 percent per year beyond the rate of inflation; at public community colleges during this time frame, they have increased by an average of 3.9 percent per year beyond the rate of inflation.
- In one year alone, between 2011-12 and 2012-13, average published in-state tuition and fees increased by 4.8 percent at public four-year institutions and 5.8 percent at public two-year colleges.
- This follows increases of 8.3 percent at public four-year institutions and by 8.7 percent at community colleges in the previous academic year[iii].

With the price of college increasing every year, many students and their families look towards educational loans—both public and private—to help cover the cost of college, presenting more and more students with a dilemma that we find unacceptable: the cost of obtaining an education that will improve their own lives and communities is an onerous debt burden that will hinder the start of their adult lives.

State disinvestment in higher education is, in turn, driven by the very real lack of revenue that states are collecting. This is partially due to the economic recession and slow recovery that devastated state budgets, and partially due to a lack of political will to consider options that would enhance revenue. As the prospects for state investment in public colleges and universities look bleak, higher education advocates are understandably searching for funding alternatives for these institutions.

The Pay It Forward Alternative

One alternative that has been receiving attention—an alternative that the AFT opposes—is called "Pay It Forward"[iv]. It is billed as a "social insurance" program, and works as follows: students in a state where it is adopted would be able to attend a public college or university in that state with no up-front costs. How many students are included initially would depend on the funding available. Although unlikely, given the cost, the state could cover the up-front costs of *all* students immediately, or barring that, apply for grant money to cover those costs. A more likely scenario would involve converting an existing pool of money already used for financial aid into a fund that would cover a portion of students, and then as the fund builds, would cover more students until all are covered. The fund builds in the following way: upon leaving school, students would have a percentage of their income—.75 percent per year for community college students (which adds up to 1.5 percent for graduating with a two-year degree), 1 percent per year for students at four-year institutions (or 4 percent, assuming that the student graduates in four years) is what is proposed—deducted from their paycheck for 25 years. The increasing numbers of students in the program (eventually *all* students), and the projected increase in incomes, and hence revenue generated from incomes, is projected to provide a stable method of funding higher education. At first blush, this seems like a solution that would relieve the high debt burden for many students while providing a stable funding source for public institutions. *However, upon closer inspection, Pay It Forward has pitfalls that actually reduce the affordability of college for low-income students and undermine the notion of higher education as a public good.*

To be clear, we are not opposed to the idea of income-based (or income-contingent or income-sensitive) repayment (IBR) plans such as those currently used by the federal government for loans. While we believe these plans could be improved to more effectively target those who are most in need, the key is that these plans are *intended to supplement need-based grant assistance*. In this context, IBR is an important—and relatively unobjectionable—tool for providing financial aid for students and managing that debt on the back-end. When income-based repayment becomes seen as a *funding mechanism* for higher education is when problems arise.

Our Concerns

First and foremost, IBR-based funding of higher education exacerbates the on-going trend of envisioning higher education as a *private transaction* that accrues benefits to the individual rather than as a *public good* that brings economic and civic benefits to communities[v], as well as the individual. IBR-based funding mechanisms continue the shift of financing higher education from the state to the private individual. Unlike other social insurance programs, such as Social Security or Medicaid, into which *all* taxpayers pay, Pay It Forward collects revenues only from those who attend a public college or university. Although the Pay It Forward proposal does include a provision for a minimum of state revenue to support public higher education institutions (see below), it is clear that, over time, an increasing proportion of the higher education budget will come from assessments to individuals who have attended college. In this way, Pay It Forward more resembles a fee-for-service, albeit a fee that is collected after the service is rendered, than a social insurance program. Indeed, this shifting of costs from the public to the private individual is a central premise of IBR-based funding plans proposed by Milton Friedman in the 1950s, which are the provenance of Pay It Forward[vi].

Pay It Forward and other IBR-based funding schemes also have the potential to completely undermine need-based financial aid. For example, the Pay It Forward proposal explicitly turns Washington State's Husky Promise program—which guarantees free tuition for low-income undergraduates (about 25 percent of the undergraduate population) at the University of Washington—into seed money for Pay It Forward[vii], which will cover all students. Essentially, low-income students who had been guaranteed a free education at the University of Washington will be on the hook for paying back 4 percent of their income for 25 years of their working life in order to subsidize students from higher-income backgrounds. Similarly, for many low-income students, need-based financial aid will cover the *entire* cost of attending a community college[viii]. Pay It Forward would replace this free education for low-income students with a 1.5 percent income deduction for 25 years. This is especially problematic when the prospect of long-term debt is cited as a primary barrier to low-income students seeking higher education[ix].

The problem is compounded by the fact that those who are most likely to receive need-based aid—racial minorities and/or students from low-income backgrounds—also often lack access to higher-paying jobs and face discrimination in the form of structural wage gaps[x][xi][xii]. A flat percentage of income—essentially a *flat tax*—deducted from everyone who attends a public college or university over 25 years will have a bigger impact on those at the lower end of the income scale. Obviously, tuition and student debt is far too burdensome for middle-class families and students as well, but it makes little sense pitting students from middle-class families against those from lower-income families who receive financial aid in the name of "fairness" at a time when we should be focused on making college more affordable for everyone.

There are a host of other issues that could arise from the implementation of Pay It Forward and other IBR funding policy proposals.

- There is a high likelihood that parents and individuals who have saved for their children's college education to avoid post-graduate debt will work to maintain this privilege. This may require political concessions in the form of modifications to Pay It Forward that would allow families who can afford it to pay up front. In this case, the post-graduation funding burden will again fall on lower-income students—students who previously would have been attending college at reduced or no cost because of need-based financial aid—and on those who can't afford to pay up front. It is also conceivable that students who pay up front would pay *less* than those who are having a percentage of their income assessed for 25 years.
- "Wealth gaps" between different types of institutions could be institutionalized and hardened if Pay It Forward repayments go directly to the institution—an option in the proposal. Research universities will tend to produce higher income graduates compared to community colleges, which serve lower-income communities *and* a much larger population within a state.
- Given the corporatization of higher education, college administrators will be given a strong incentive to favor programs which will generate higher-income graduates in order to strengthen funding. This further vocationalizes higher education and has the potential to hollow out the liberal arts core of the modern university. There will also be a strong incentive to admit students who are more likely to contribute to their funding stream with higher income jobs.
- Pay It Forward also envisions having states commit to a minimum level of higher education funding to supplement the funds gathered through post-graduation income assessments. If this is an integral part of the plan, the question must be asked: why not have the state commit to a minimum level of higher education funding that makes a public college or university affordable to everyone without a 25-year payment commitment?

- As a corollary to the previous point, state legislatures are not beholden to the laws passed in previous sessions. Given the ongoing pressures to cut state budgets, future state legislators could vote to reduce the minimum state funding for higher education and raise the percent of income that is assessed post-college for Pay It Forward. Pay It Forward, in fact, lays the institutional and bureaucratic foundation by which the state can stop using tax revenues to fund higher education altogether, thus completing the shift from the public to the private individual for paying for higher education.
- There are also a number of practical considerations in the implementation, some of them which will incur costs to the state, that should be considered:
    - It will require a system to collect Pay It Forward revenues—either within a state or nationally. For example, Washington State does not have an income tax; therefore it will be necessary to put in place a structure by which the state can assess Pay It Forward fees from a graduate's income. Agreements will also have to be made with the federal and/or other state governments in order to assess Pay It Forward fees from graduates who have moved out of state.
    - Proponents of Pay It Forward state that their proposal will not affect students' access to federal need-based financial aid. However, federal aid is calculated based on an institution's total cost of attendance and a student's (or their family's) ability to pay. By reducing tuition and fees to $0, the total cost of attendance, and therefore need-based financial aid, is reduced, unless the formula for determining how federal financial assistance is changed. It is again worth noting that with Pay It Forward, the poorest students who, with federal need-based financial aid have been able to obtain a college education for free, will be paying *more* for their education.
- Finally, this is a bad precedent. If this approach to funding higher education, an approach which transfers the burden of financing higher education from the public to the individual, catches on, we have grave concerns regarding the viability of federal financial aid programs, like the Pell Grant, which historically have helped low-income students attend college at a time when cutting the federal budget is a high political priority.

Pay It Forward and other income-based repayment-based funding models are not progressive. Rather than spreading the cost of higher education—a public good which brings economic and civic benefits to *all* of the community—to all taxpayers via progressive taxation, these proposals shift the burden of higher education solely on to the individual student via a flat tax with a long repayment period. The impact of this will be felt by lower-income and less advantaged demographic groups and, contrary to assertions, will make college *less* affordable and *less* accessible to these populations.

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[i] State Higher Education Executive Officers. (2012). *State Higher Education Finance FY 2011*, p. 7. Available at www.sheeo.org/sites/default/files/publications/SHEF_FY11.pdf

[ii] Quinterno, J. & Orozco, V. (2012). *The Great Cost Shift: How Higher Education Cuts Undermine the Future Middle Class.* DEMOS, p. 2. Available at www.demos.org/publication/great-cost-shift-how-higher-education-cuts-undermine-future-middle-class

[iii] College Board Advocacy & Policy Center. (2012). *Trends in College Pricing 2012.* Available at trends.collegeboard.org/sites/default/files/college-pricing-2012-full-report_0.pdf

[iv] Economic Opportunity Institute. (October 2012). *Pay It Forward: Refinancing Higher Education to Restore the American Dream.* Available at www.eoionline.org/education/reports/PayItForward-Oct12.pdf

[v] See the College Board's report, *Education Pays 2010: The Benefits of Higher Education for Individuals and Society* (available at trends.collegeboard.org/sites/default/files/education-pays-2010-full-report.pdf).
[vi] Canadian Association of University Teachers. (December 2006). "Income Contingent Loan Repayment Plans: The False Promise of Fairness." *CAUT Education Review*, 8(3): 1.
[vii] Economic Opportunity Institute. (October 2012). *Pay It Forward: Refinancing Higher Education to Restore the American Dream*, p. 8.
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[xii] Zimmerman, D.J. (June 1992). "Regression Toward Mediocrity in Economic Stature." *The American Economic Review*, 82(3): 409-429.