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BALANCED BUDGET TALKING POINTS #3: WHAT A BALANCED FEDERAL BUDGET WITH TAX CUTS WOULD MEAN FOR FAMILY COLLEGE COSTS

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Congress's balanced budget with tax relief legislation will allow families with children to save more money for higher education. A balanced budget with tax cuts also will lead to lower interest rates which will benefit students by lowering the cost of student loans. Both of these consequences of balancing the budget over seven years with tax relief mean more highly skilled Americans for future workforces. These are the findings of an analysis by The Heritage Foundation using one of the principal econometric models of the U.S. economy.

According to this statistical analysis, the Balanced Budget Act developed by Congress would mean:

- ✓ **American families, over time, could save an additional \$14,066 per child in today's dollars** to fund college education costs as a result of the \$500-per-child tax credit. This would cover the full tuition costs at a typical public university today.
- ✓ **An average student could save more than \$414** over the life of a 10-year student loan as a result of lower interest rates.

Economists at The Heritage Foundation conducted an interim econometric analysis of the congressional balanced budget plan using the economic model developed by Laurence H. Meyer & Associates, a nationally recognized economic consulting firm.¹ The Meyer model is used by many major public agencies and private firms, such as the President's Council of Economic Advisers, the Office of Management and Budget, the Board of Governors of the Federal Reserve, and the Congressional Budget Office.²

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1 William W. Beach and John S. Barry, "What a Balanced Federal Budget with Tax Cuts Would Mean to the Economy," Heritage Foundation *F.Y.I.* No. 69, November 14, 1995.

2 Laurence H. Meyer & Associates long has earned top honors for forecasting accuracy when compared against similar firms. In 1993, it won the "Blue Chip" forecasting award for the years 1989-1992. Laurence H. Meyer &

INCREASED FAMILY SAVINGS FROM \$500-PER-CHILD TAX CREDIT

The high cost of a college education prices many families out of the higher education market or forces students and parents to incur large amounts of debt to cover the costs of college.

The \$500-per-child tax credit included in the Balanced Budget Act of 1995 would benefit more than 28 million families raising some 51 million children and could allow many families to save enough money to send their children to college. A family that chooses to dedicate the entire \$500-per-child tax credit to savings for higher education would accumulate about \$14,066 in today's dollars over 18 years for each child's education. Thus, a family with two children would be able to save an additional \$28,132 for college expenses. In today's dollars, an additional \$14,066 per child in family savings for education amounts to:

- ✓ Five full years' tuition and fees at an average public university;
- ✓ One full year's tuition and fees at an average private university; or
- ✓ More than the difference between the four-year cost of an average public university and the two-year cost of an average public community college.

LOWER STUDENT LOAN INTEREST RATES

The economic simulation conducted by analysts at The Heritage Foundation indicates that households and businesses would face lower interest rates under the congressional balanced budget and tax cut plan than under current budget and tax policy. Lower interest rates also would benefit students with student loans. A student beginning his or her education in 1996 would face interest rates that averaged half a percentage point below what is expected under current law: a savings of \$414 over the life of an average ten-year student loan.³ More young Americans will be able to afford a college education as a result of these savings. In addition, some students who otherwise would have to defer their education plans could enter college earlier, thus increasing their lifetime earnings.

Alternatively, lower interest rates would allow students to borrow more money for education at the same effective cost. In essence, students would be able to purchase more education for the same price. The additional \$414 might be used for such things as:

- ✓ One full year of books and supplies;
- ✓ Two additional courses at an average public university; or
- ✓ About one-third the cost of a personal computer.

Associates was ineligible for the award in 1994, but again was rated the most accurate forecasting firm in the United States.

3 This is based on a student loan of \$13,044, the average cost of a public university, at an initial interest rate of 8.25 percent. The Heritage Foundation econometric analysis assumes that the Federal Reserve System makes no change in the reserve requirements of its member banks and refrains from stimulating the economy by increasing the growth of monetary reserves. This assumption means a relatively smaller decrease in interest rates. Thus, the 0.5 percent decrease can be viewed as a conservative estimate of the potential savings to a student from lower interest rates.

TECHNICAL ASSUMPTIONS

For assumptions that underlie the econometric simulation of the congressional balanced budget legislation, see William W. Beach and John S. Barry, "What a Balanced Federal Budget with Tax Cuts Would Mean to the Economy," Heritage Foundation *F.Y.I.* No. 69, November 14, 1995.

For purposes of calculating the amount of savings from a \$500-per-child tax credit, it was assumed that the money was placed in a super-IRA (as defined by the Congressional Budget Resolution of 1995) earning a real rate of return of 5 percent per year.

The initial rate of interest charged for a student loan was assumed to be 8.25 percent. The 0.5 percent figure is an average decrease below baseline for the life of a ten-year student loan. This 0.5 percent decrease was projected in the above-cited econometric simulation.

Chart 1

A Family Saving the Entire \$500 per Child Tax Credit for 18 Years Could Accumulate \$14,066: Paying for Their Child's Education at An Average Public University or More than a Year's Worth at a Typical Private University

	Public University	4 Year Cost	School Years That Savings From the \$500 Tax Credit Will Buy	Private University	4 Year Cost	School Years That Savings From the \$500 Tax Credit Will Buy
Alabama	U. of Alabama at Birmingham	\$10,044	5.6	Spring Hill College	\$48,492	1.2
Alaska	U. of Alaska Fairbanks	\$9,952	5.7	Sheldon Jackson College	\$37,520	1.5
Arizona	U. of Arizona	\$7,576	7.4	Prescott College	\$39,840	1.4
Arkansas	U. of Arkansas	\$9,208	6.1	John Brown University	\$28,344	2.0
California	U. of California - Los Angeles	\$15,572	3.6	Loyola Marymount University	\$55,072	1.0
Colorado	U. of Colorado at Boulder	\$10,796	5.2	Regis University	\$51,040	1.1
Connecticut	U. of Connecticut	\$18,848	3.0	Saint Joseph College	\$48,800	1.2
Delaware	U. of Delaware	\$16,400	3.4	Wesley College	\$41,180	1.4
Florida	Florida State University	\$7,192	7.8	Barry University	\$45,160	1.2
Georgia	U. of Georgia	\$9,408	6.0	Mercer University	\$47,952	1.2
Hawaii	U. of Hawaii	\$6,228	9.0	Chaminade University of Honolulu	\$42,400	1.3
Idaho	U. of Idaho	\$6,192	9.1	Albertson College of Idaho	\$55,808	1.0
Illinois	U. of Illinois at Chicago	\$14,792	3.8	Loyola University College	\$46,000	1.2
Indiana	Indiana University - Bloomington	\$13,492	4.2	Huntington College	\$40,800	1.4
Iowa	U. of Iowa	\$9,820	5.7	Drake University	\$53,680	1.0
Kansas	U. of Kansas	\$8,152	6.9	Benedictine College	\$38,640	1.5
Kentucky	U. of Kentucky	\$10,040	5.6	Centre College	\$48,800	1.2
Louisiana	U. of New Orleans	\$12,208	4.6	Loyola University in New Orleans	\$45,380	1.2
Maine	U. of Maine	\$14,644	3.8	Westbrook College	\$46,600	1.2
Maryland	U. of Maryland College Park	\$13,920	4.0	Loyola College	\$52,720	1.1
Massachusetts	U. of Massachusetts - Amherst	\$21,868	2.6	Regis College	\$50,800	1.1
Michigan	U. of Michigan - Ann Arbor	\$21,888	2.6	Northwood University	\$38,660	1.5
Minnesota	U. of Minnesota - Twin Cities	\$13,568	4.1	Saint Mary's College of Minnesota	\$43,520	1.3
Mississippi	Mississippi State University	\$10,244	5.5	Millsaps College	\$47,616	1.2
Missouri	U. of Missouri Columbia	\$13,776	4.1	Saint Louis University	\$43,880	1.3
Montana	U. of Montana - Missoula	\$8,032	7.0	Carroll College	\$35,760	1.6
Nebraska	U. of Nebraska at Lincoln	\$9,660	5.8	Creighton University	\$43,856	1.3
Nevada	University of Nevada Las Vegas	\$6,960	8.1	Sierra Nevada College	\$36,200	1.6
New Hampshire	U. of New Hampshire	\$18,236	3.1	Daniel Webster College	\$49,648	1.1
New Jersey	Rutgers University	\$17,828	3.2	Seton Hall University	\$47,200	1.2
New Mexico	U. of New Mexico	\$7,536	7.5	College of Santa Fe	\$45,512	1.2
New York	SUNY at Albany	\$11,744	4.8	Saint Johns University - New York	\$39,200	1.4
North Carolina	U. of North Carolina at Chapel Hill	\$6,096	9.2	Wake Forest University	\$55,400	1.0
North Dakota	U. of North Dakota	\$9,712	5.8	Jamestown College	\$30,480	1.8
Ohio	Ohio State University	\$12,348	4.6	University of Dayton	\$47,320	1.2
Oklahoma	Oklahoma State University	\$7,568	7.4	University of Tulsa	\$47,000	1.2
Oregon	U. of Oregon	\$13,032	4.3	University of Portland	\$48,800	1.2
Pennsylvania	Pennsylvania State University	\$20,144	2.8	Drexel University	\$52,304	1.1
Rhode Island	U. of Rhode Island	\$16,968	3.3	Bryant College	\$50,400	1.1
South Carolina	U. of South Carolina at Columbia	\$12,784	4.4	Wofford College	\$50,720	1.1
South Dakota	U. of South Dakota	\$10,320	5.5	Augustana College	\$44,460	1.3
Tennessee	U. of Tennessee - Memphis	\$9,916	5.7	Maryville College	\$45,400	1.2
Texas	Texas A&M University	\$7,080	7.9	Rice University	\$41,600	1.4
Utah	U. of Utah	\$9,524	5.9	Westminster College of Salt Lake City	\$35,280	1.6
Vermont	U. of Vermont	\$26,608	2.1	Trinity College of Vermont	\$45,080	1.2
Virginia	U. of Virginia	\$17,920	3.1	Washington and Lee University	\$55,540	1.0
Washington	Washington State University	\$11,632	4.8	Gonzaga University	\$52,000	1.1
West Virginia	West Virginia University	\$8,512	6.6	University of Charleston	\$38,000	1.5
Wisconsin	U. of Wisconsin - Madison	\$10,948	5.1	Marquette University	\$46,440	1.2
Wyoming	U. of Wyoming	\$7,632	7.4	(no private universities listed)		

Note: School costs are based on 1994 tuition figures. Amount saved based on assumed 8% return on savings and 3% inflation rate, adjusted to 1994 dollars.
Source: Heritage calculations, based on Department of Education, "Basic Student Charges at Post-Secondary Institutions: Academic Year: 1994-95"