CATO
POLICY
ANALYSIS

April 23, 2026 Number 1016

Federal Budget Reform Opportunities in Higher Education for 2026

By Andrew Gillen

EXECUTIVE SUMMARY

Over the decades, federal programs have accumulated in higher education. Some of these programs have been rendered obsolete or redundant by subsequent developments, while others have failed to achieve their intended purpose. As a result, there are several federal policy reforms that would improve higher education policy and save taxpayers money. In this report I identify policies that would save more than $265 billion over the next 10 years, including eliminating subsidized loans, eliminating or capping Public Service Loan Forgiveness, modifying the Repayment Assistance Plan, phasing out campus-based aid, repealing ineffective tax expenditures, and benchmarking research overhead rates.

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INTRODUCTION

The federal government's various higher education programs have evolved over the decades, sometimes in strange and unpredictable ways. The historical pattern is for some perceived need to justify the creation of a new program, which is layered upon the existing programs and then largely left unattended for decades. As a result, we are currently saddled with a plethora of higher education programs for which the original justifications no longer hold true, or else a program persists despite having been a failure. For example, one of the first large federal financial aid programs was the work-study program that subsidizes student jobs on campus. It was created during the Great Depression with the goal of shrinking the size of the labor force at a time of high unemployment.[1] Mass unemployment is not a problem these days, yet the work-study program still exists today.

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The only silver lining is that it is possible to find reforms that both improve higher education policy and save taxpayer money. These policy reforms are concentrated in student lending, campus-based aid, tax expenditures, and research overhead reimbursement.

The One Big Beautiful Bill Act of 2025 Provides a Guide

Last year's reconciliation bill was the most substantial higher education legislation in decades. The bill made major changes to student loans, Pell Grants, and even the university endowment tax. Notable successes include eliminating GradPLUS loans, capping ParentPLUS loans, phasing out many of the overly generous income-driven repayment plans, allowing colleges to limit their students' borrowing, and introducing an earnings-based accountability measure. These reforms were desirable in their own right, but notably, they also contributed to $320 billion in savings.[2] The 2025 bill provides a guide to implementing substantial changes that yield both better policy and budgetary savings.

2026 REFORM OPPORTUNITIES IN HIGHER EDUCATION

With the possibility of another reconciliation bill being passed this year, we've compiled a host of reforms that both improve policy and save substantial money for taxpayers.

Student Loans

Key opportunities for reforming federal student loans include eliminating subsidized loans, reforming Public Service Loan Forgiveness, and amending the soon-to-be launched Repayment Assistance Plan.

Eliminate Subsidized Student Loans

While all types of student loans are subsidized in the sense that taxpayers fund them, the type of loan that is formally called "subsidized" waives interest charges while the student is still enrolled in college. Most undergraduates can currently borrow $3,500 (for freshmen); $4,500 (for sophomores); and $5,500 (for juniors and seniors) per year in subsidized loans, and another $2,000 in unsubsidized loans.

Eliminating subsidized loans is desirable for several reasons. First, money in the future is less valuable than money today. But interest-free loans, such as subsidized loans while the student is in school, ignore this fact and pretend that there is no difference in having money today or years from now.

Second, subsidized loans may not have as large an effect on enrollment as their supporters suggest. Many students already take out a mix of subsidized and unsubsidized loans. A survey found that 13 percent of students were not aware they had taken out a loan, and 37 percent substantially underestimated the amount they owed, with 9 percent underestimating their balance by at least $10,000. If this many students don't even know whether they have loans or have a rough idea of their balance, an even higher share likely would be unaware of how much of their loan balance

was comprised of subsidized loans. That, in turn, implies that the subsidized loans are not influencing some students' enrollment decisions.

Third, subsidized loans have been eliminated before, and it worked out well. In particular, the Bipartisan Budget Act of 2011 (Public Law 112-25) eliminated subsidized loans for graduate students, with no detectable impact on student enrollment.[3] Indeed, students continued to enroll in graduate programs, and those programs continued to proliferate across the country. Nor is there a large and vocal political movement to bring back subsidized loans for graduate students, indicating that the persistence of those loans was largely attributable to inertia rather than the program fulfilling a real and significant need.

"Public Service Loan Forgiveness should be eliminated or capped for two main reasons: it is poorly designed and it is unfair."

Fourth, the common critique of polices that end student loan programs—that it would restrict access to higher education—is not a factor when eliminating subsidized loans because it does not alter how much students can borrow. Federal maximum loan limits apply to the combined sum of subsidized loans and unsubsidized loans, which means that for every dollar of subsidized loans that a student loses access to, they gain access to a dollar of unsubsidized loans. For example, a dependent freshman who previously could have borrowed a total of $5,500 with a mix of subsidized (up to $3,500) and unsubsidized loans will still be able to borrow $5,500, only now it would all be unsubsidized. In other words, if subsidized loans were eliminated, students would still be able to borrow as much as they can now. The only difference would be that interest would begin accruing on all their loans rather than a portion of them.

How much money would eliminating subsidized loans save for taxpayers? While taxpayers lose money on all types of loans (with the exception of Parent PLUS loans), subsidized loans cost taxpayers about seven cents more per dollar lent than the unsubsidized version. Using the most recent Congressional Budget Office estimates of the volume and cost of student loans indicates that eliminating subsidized student loans would save around $14.1 billion over the next decade (this figure assumes that all subsidized loans would convert into unsubsidized loans).[4]

Eliminate or Cap Public Service Loan Forgiveness

Public Service Loan Forgiveness (PSLF) is a program designed to encourage borrowers to work for public or nonprofit employers by offering loan forgiveness in return. Created by the College Cost Reduction and Access Act of 2007, the program allows borrowers who work for public or nonprofit organizations to have any remaining balance on their loans forgiven after making 10 years of payments while working for such employers.

Public Service Loan Forgiveness should be eliminated or capped for two main reasons: PSLF is poorly designed and it is unfair. The program's design is misguided and badly targeted. The premise of PSLF is that those who work for public or nonprofit organizations are either more valuable to society than those who don't, or are undercompensated relative to those who don't. There is little reason to believe that is the case.

But even ignoring this, and assuming that PSLF is justified because public sector workers are more valuable to society or are undercompensated, PSLF is poorly targeted. The program only provides enhanced funding for workers who took out student loans, and it provides the most funding to those who took out the largest loans. If public and nonprofit workers deserve more compensation, then they should all get more compensation, not just those who took out student loans.

The PSLF is also unfair in multiple ways. Consider two nurses who went to the same college and borrowed the same amount. The one working for a nonprofit hospital will have any remaining loans forgiven after 10 years of repayment, while the one working for a for-profit hospital will have to repay all loans on their own. The program is also unfair in the distribution of funding. In 2023, borrowers who had loans forgiven through PSLF had an average of $97,982 forgiven.[5] This is a massive amount of money compared to the aid available to other students. The most disadvantaged student imaginable would be eligible for a maximum Pell

Grant of $7,395 per year, or just under $29,580 over four years. In contrast, government workers—who are often well paid and have higher-than-average job security and excellent benefits—are getting an average of $97,982 in loan forgiveness through PSLF.

How much money would eliminating or capping Public Service Loan Forgiveness save? The Committee for a Responsible Federal Budget estimated that eliminating PSLF would save $30 billion over the next 10 years. Capping forgiveness would also yield substantial savings, with a cap of $10,000 per borrower saving $25 billion, and a cap of $57,500 (the maximum amount that can be borrowed for an undergraduate degree) saving $15 billion.[6] Note, however, that all these estimates were made prior to the replacement of many income-driven repayment plans with the less generous Repayment Assistance Plan (RAP), which will likely reduce the estimates cited above.

Cap the Repayment Assistance Plan's Interest Waiver and/or Principal Match

Recent legislation replaced many of the existing income-driven repayment plans with RAP. This plan is an improvement over the older plans, but it also contains two features that could be amended to further improve policy and cut costs for taxpayers.

The most promising change would be to cap the interest waiver. Under RAP, if a student makes a payment that does not cover all the accrued interest, the remaining unpaid interest is waived. Interest waivers should be avoided. As noted earlier, there is a time-value cost of lending money, a cost that waiving interest on student loans passes from borrowers to taxpayers. More concretely, the federal government is running deficits, and is therefore paying around 3.5 percent in interest to borrow money it then lends to students, who pay no interest if they receive an interest waiver.[7] In addition, the waiver effectively provides additional subsidies for types of education where the benefits do not justify the costs (at least in financial terms) because interest waivers often will be given to students in academic fields or colleges where their salaries are low relative to their student loan debt. These sorts of investments (where costs are higher than benefits) should not be encouraged with additional subsidies.

While eliminating the interest waiver entirely would be ideal, capping the amount of interest that can be waived to the amount attributable to undergraduate debt would be a step in the right direction.

Another small beneficial change to the RAP plan would be to modify the principal match. Under RAP, if a borrower's payment does not lower their balance by $50, the borrower is eligible for a principal match to ensure their principal is reduced by the lesser of $50 or the amount of their payment less any portion that repaid principal. For example, if a borrower makes the $10 minimum payment, the principal match will reduce their principal by $10 (assuming more than $10 of interest accrued). Adjusting the amount or phasing in the principal match could yield budgetary savings.

Another possible reform would be to keep the interest waivers and principal match unchanged, but to make the college that the student borrowed to attend pay for these, rather than taxpayers. This would introduce an element of risk-sharing to student loans, which would align colleges' incentives with those of students and taxpayers, while also reducing the financial losses that taxpayers take on student loans.

Campus-Based Aid Programs

While the bulk of federal financial aid is distributed directly from the government to the student, the campus-based aid programs provide taxpayer funding to colleges, which then have a large amount of discretion over who receives the aid. The campus-based aid programs include the Federal Supplemental Educational Opportunity Grant Program (FSEOG), work-study, and Perkins loans. Perkins loans are in the process of being phased out; the last loans were issued in 2017–2018, although repayment of existing loans will take many more years. The FSEOG and work-study programs should end as well.

Campus-based aid programs allow colleges to determine aid recipients, even though the government is providing most of the funding. Outsourcing these decisions about how to spend taxpayer money to colleges is inappropriate and potentially prone to abuse.

Campus-based aid programs can also be redundant. The FSEOG is designed to provide low-income students with

grants to attend college. Yet Pell Grants have the exact same purpose and are better designed, targeted, and funded.

Campus-based aid funding is also distributed inequitably. While ostensibly justified by the financial need of their students, campus-based aid is not distributed to colleges based on how many needy students they have, but rather based on their historical political power. A Congressional Research Service report found that "the majority of funding provided for the programs is allocated to institutions in proportion to the amount they received in previous award years, as opposed to being allocated entirely according to the aggregate financial need of the students attending each institution."[8] The result is that politically connected colleges have been able to capture more campus-based aid than their share of needy students warrants. For example, for 2023–2024, New York University had the seventh-highest FSEOG funding among all universities, yet it ranked 239 in the number of high-need students enrolled (as measured by Pell Grant recipients). In particular, the university had 5,677 Pell Grant recipients and received $4.2 million in FSEOG funding. In contrast, Suffolk County Community College had almost the same number of Pell Grant recipients (5,566), yet it received less than $800,000 of FSEOG funding. Nor was New York University alone. Washington University in St. Louis had 1,497 Pell Grant recipients and received $629,000 in FSEOG funding, whereas Northwest Missouri State University had even more Pell Grant recipients (1,660), yet it received much less FSEOG funding ($181,000).[9] The bias of the campus-based aid funding formulas toward older and politically connected colleges is not a legitimate distribution method and runs contrary to the American ethos.

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Taxpayers contribute around $900 million per year to the FSEOG, so eliminating the program would save around $9 billion over 10 years.[10] Alternatively, the federal share of FSEOG aid could be reduced. Currently, federal taxpayers typically pay 75 percent of FSEOG awards, with colleges providing the other 25 percent. Reducing the federal share to 50 percent could save around $3 billion over the next decade.

Work-study costs federal taxpayers around $1.2 billion per year, so eliminating work-study would save $12 billion over the next 10 years.[11] Like FSEOG, work-study has a matching requirement, so reducing the federal share (typically 75 percent, as in FSEOG) to 50 percent would yield around $4 billion in savings.

Higher Education Tax Credits and Deductions

Analysts have long known that tax credits and deductions are a poor tool to use to advance higher-education goals. Alice Rivlin, who was influential in designing the first federal aid programs, wrote that "when compared with scholarship or subsidized loan plans, tax credits to families are an inefficient policy instrument for furthering higher education objectives."[12] Until the mid-1990s, there were no substantial tax credits or deductions for higher education. Unfortunately, credits and deductions have since proliferated to the point that they now constitute the most-used type of federal financial assistance for college. In 2024–2025, 8.4 million recipients took advantage of at least one credit or deduction, at an average of $1,410 per recipient.[13] Indeed, the Internal Revenue Service now has a 79-page document explaining some of the credits and deductions.

The main problem with using tax credits or deductions in higher education is that they fail spectacularly, regardless of their purported goal. If the goal is to increase college enrollment, they fail because they don't increase enrollment enough to justify the cost. Scholars have found that "much of this money is a pure transfer, received by students who would have attended college in the absence of public support."[14] An analysis of one of the first tax credits found that "93% of President Clinton's Hope Scholarship Funds, which were directed towards middle-class families, were given to children who would attend school even without the program."[15] Two more recent studies found "zero effect of the tax benefits on college enrollment."[16] This shouldn't be too surprising, as the size of the tax benefits (an average of $1,410) is simply too small to induce many additional enrollments.

But even if tax credits and deductions don't have much effect on who enrolls, perhaps they at least make enrollment more affordable. Unfortunately, this isn't happening either, because colleges often alter their pricing and financial aid packages to capture the credits and deductions. Colleges that charged less than a newly announced tax credit tended to "react to the credits by raising prices."[17] Colleges that were already charging more than the tax credit didn't raise prices, but they did tend to reduce the financial aid they offered out of their own funds "roughly dollar-for-dollar."[18] When colleges raise prices or cut other financial aid in response to tax credits and deductions, they capture the value of the tax credit or deduction for themselves rather than letting students and parents benefit.

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Eliminating or scaling back tax credits and deductions would yield extra revenue and reduce market distortions. The Joint Committee on Taxation provides estimates of the cost of these tax expenditures, which can function as first approximations to the extra revenue raised from elimination of tax credits.[19] For example, eliminating credits such as the American Opportunity Tax Credit and the Lifetime Learning Credit would raise an additional $132 billion over the next 10 years. Eliminating other exclusions and deductions would also raise considerable additional revenue. The largest opportunities include the exclusion of scholarship and fellowship income ($56 billion) and the deduction of student loan interest ($26 billion).

Benchmark Overhead Reimbursement for Federally Funded Research

When the federal government funds research, the funding is split into the direct research costs associated with a project, such as salaries for the researchers who are working on the project, and indirect costs that are not easily attributable to any particular project, such as utilities and administrative costs. Indirect costs go by several different names, including overhead and facilities and administrative costs.

Indirect rates are currently negotiated between each college receiving substantial research funding and the Department of Health and Human Services or the Office of Naval Research. There is no official and comprehensive listing of indirect rates, but some researchers recently calculated that the average indirect rate for National Institutes of Health grants at top universities was 58 percent.[20]

Overhead Rates Are Too High

Some indirect costs are legitimate, but there are strong reasons to believe that the current indirect rates paid by the federal government to universities are excessive.

For example, the Government Accountability Office found that National Science Foundation grants to universities had an average indirect rate of 27 percent. The rate for National Science Foundation grants to industry was just 14 percent.[21]

Second, universities have been caught inflating indirect rates in the past. Most memorably, in the 1990s, Stanford University was caught inflating indirect costs for reimbursement by including depreciation for a yacht and a host of other nonresearch costs, including "cedar closet liners and cabinets, floral arrangements, sterling silverware and other silver items for the President's House."[22] A Government Accounting Office report from that era bluntly concluded "unallowable, questionable, and improperly allocated indirect costs were found at all four universities we reviewed as well as at virtually every university that other audit agencies reviewed."[23] A more recent example occurred at City University of New York, where overly generous indirect rates appear to have allowed the university to grant a researcher a "lush fund" which was used to pay for alcohol, parties, and other personal expenses.[24]

Third, rates are historically high, even exceeding rates that were once thought to be overly generous. To encourage universities to focus on the war effort during World War II, indirect rates were set deliberately high, at 50 percent.[25] The average National Institutes of Health rate is now even higher, at 58 percent, with some universities even getting 69 percent.[26]

Fourth, rates should fall as funding grows, but instead they rise. As Jay Greene, previously of the Heritage Foundation and now of the Defense of Freedom Institute, points out:

> If the overhead rate is supposed to cover fixed costs that cannot be allocated to individual research projects, it should be the case that overhead rates would go down as research funding went up. But the opposite is true. Overhead rates have risen as the government has massively increased spending on research. And universities that receive significantly more research funding actually charge higher overhead rates than institutions getting less funding. Overhead cost rates are driven more by accounting shenanigans than economies of scale.[27]

Fifth, indirect rates are set based on what universities spend, with little scrutiny. If a university spends more on buildings or hires more administrators than it might need, it is rewarded with a higher indirect rate.

Sixth, some researchers have found that the current method results in "overcompensating universities for federally sponsored research," since indirect rates fund infrastructure that has economies of scale or scope benefits for other university activities.[28]

Seventh, universities can double-dip when it comes to facilities paid for by donors. Some buildings are "financed from new and separate university funds (donors, state construction budgets), enabling the university to collect twice for building costs (the second time through indirect cost recovery)."[29]

Use Benchmarks Instead of Negotiation to Set Overhead Rates

After evaluating the current system for determining overhead rates, economists Roger G. Noll of Stanford University and William P. Rogerson of Northwestern University proposed a benchmarking system, where a single rate would be set for all similar universities. Such a system has two main advantages. First, it would be much less costly to implement, for both universities and the federal government, since each university would no longer be required to negotiate its own unique overhead rate. Second, unlike the current system, which rewards excessive spending, it would create a "powerful incentive to eliminate excessive overhead expenditures" because the university is no longer reimbursed for excessive spending and would also get to keep any realized savings if it reduces its spending below the benchmarked rate.[30] As rates are updated periodically, these savings would then lower the overhead rate paid to all universities, saving taxpayers money.

Adopting a benchmark rate for all indirect costs would be ideal. But at a minimum, it would make sense to adopt a benchmark for administrative costs. To begin with, there has been a cap on administrative costs in place since the early 1990s, so the new benchmark rate can be thought of as modifying the existing cap. Scholars have found that the "aggregate rate for all administrative costs exhibited little variation among universities, so that adopting one rate for all would cause little disruption."[31] A university would also be reluctant to make a strenuous case that its administrative costs were higher than other universities' administrative costs, since this could create public-relations problems. Once implemented, a similar benchmark could be used for facilities.

CONCLUSION

Federal higher education policy has evolved through expansions, temporary compromises, and political accommodations that have rarely been revisited in a systematic way. As a result, there are a host of policies in place that are obsolete or that have failed to achieve their intended purpose, which in turn means that there are policy reforms that would both improve higher education policy and save taxpayers money. Key reforms and their potential savings for taxpayers over the next 10 years include:

- eliminating subsidized loans (up to $14 billion);
- eliminating or capping Public Service Loan Forgiveness (up to $30 billion);
- modifying the Repayment Assistance Plan;
- phasing out campus-based aid (up to $21 billion);
- repealing ineffective tax expenditures (over $200 billion); and
- benchmarking research overhead rates.

Reconciliation legislation presents the most plausible opportunity to implement these changes and could generate $265 billion in savings for taxpayers over the next decade.

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CITATION

Gillen, Andrew. "Federal Budget Reform Opportunities in Higher Education for 2026," Policy Analysis no. 1016, Cato Institute, Washington, DC, April 23, 2026.

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