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Dealing with Affordability Thoughts for the Affordability Task Force Future of Higher Education Commission

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The Questions

Are American universities becoming less affordable, and, if so, what should we do about it? Before even attempting to answer those questions, we must ask the question: affordable for whom? The students (and their parents) who are attending college? For the nation as a whole? For the colleges and universities themselves – are some forms of education more “affordable” to the institutions than others?

Affordability to Students

The Stylized Facts

Starting with the question of affordability to students, it is indisputable that the costs of college have risen faster than overall inflation and, in recent years, even faster than the rise in family incomes. Thus the financial burden of college has grown. The evidence also is that this increased burden impacts more on relatively less affluent students who are more sensitive to price, thus raising the issue of the impact of reduced affordability on educational access.

Even with higher costs, however, college “investments” are good ones for the student from a strictly financial perspective, as rising tuition charges have been roughly offset by an increase in the ratio of college to high school graduate earnings differential. Moreover, the “sticker prices” of colleges are increasingly discounted through scholarships, and student loan programs help students borrow the money to get through school. Yet even these “loans”, although subsidized to some extent, represent a financial obligation to students. Also, the evidence shows that, even if one looks at the *net* tuition – gross tuition minus discounts in the form of scholarships – real costs have risen significantly faster than the rate of inflation. So even if college is a decent, even good, investment, for some there are significant cash flow problems involved in financing this investment, aggravated by the fact that close to half of the students entering four year programs fail to graduate within even five years (and for whom, consequently, the investment on balance probably does not have a high rate of return).

In addition, with respect to scholarships, it is a demonstrated fact that an increasing proportion of student financial aid has been awarded on criteria other than financial need. Income-specific data shows that, even if one controls for student academic ability, the burden of attending college is much greater for large segments of the population with below average incomes, lowering participation.

Reasons for Rising Prices

When the price of something goes up, it is either because the demand for that something has risen, or the supply has fallen (or a combination of both). The simultaneous increase in both tuition fees and enrollments over time suggest that the increase in demand is the dominant factor. Yet the increase in demand could have been offset by an increase in supply. In less technical English, colleges and universities could have used incremental funds to greatly expand capacity. Yet large portions of American higher education have not done this, including virtually all the prestigious private research universities and liberal arts colleges, and most flagship state universities as well.

When Amherst College, Northwestern University, or the University of Michigan receives an infusion of new funds from private donors or legislative appropriations, they do not use these funds to expand enrollments – the evidence is crystal clear on that. It is nearly as true of numerous less prestigious institutions as well. Indeed, institutional prestige is enhanced by *increasing the proportion of students denied admission*, and enrollment expansion potentially lowers perceived institutional reputation. Thus the incentives to expand enrollment are outweighed often by disincentives associated with that move. These factors, along with falling or stagnant university productivity and institutional emphasis on matters other than undergraduate instruction help explain the rise in college costs.

On the demand side, well intended government financial assistance programs have been largely self-defeating. Suppose the federal government increases student financial aid in a year by 10 percent (actually, below the average for the years since 1994); typically within a year, the colleges raise fees by 7 or 8 percent. Since students receiving large assistance payments or loans are relatively insensitive to price, and since the supply of “slots” available is also relatively inelastic because of selective admission policies at many schools, the increase in demand induced by increased student assistance has aggravated tuition increases. Moreover, limits on assistance popular with low income families (e.g., Pell Grants) have risen relatively modestly compared with loans to more affluent students. The student loan program is increasingly an upper middle class entitlement (students from truly affluent families have also benefited significantly from the sharp increase in non-merit based scholarship aid, and tuition tax credits).

Looking again at the supply side, the increase in the amount of expensive labor used to educate any given number of students (perhaps 25 percent over the past 30 years) has aggravated the problem. For example, there are six “non-faculty professional” workers for every 100 students today in American higher education, double the number three decades ago. Within the academy, there has been some shift of resources away from undergraduate instruction, some of it externally funded (e.g., federal grant research), but some of it not. For example, average teaching loads for full professors at major research universities have fallen from perhaps 8-9 hours a week in the middle of the last century to about 5 hours today. Similar load reductions have occurred at schools with less research distinction. Institutions are using their own resources (some of them financed by tuition)

to fund research via lower teaching loads. Again the incentive system is skewed. Professors are rewarded mainly for research (where the results are measurable to some extent, and thus subject to national recognition), rather than for teaching (where results are harder to measure and excellence less easy to identify and to parlay into a national reputation). For reasons of money and prestige, on average professors strive to minimize their teaching responsibilities, particularly at the research oriented institutions. Thus universities have a lot of expensive faculty members doing modest amounts of teaching.

Affordability to Institutions

The above discussion points out that many institutions find it costly to emphasize undergraduate instruction. The most student-oriented of institutions – two-year community colleges – have lost ground financially relative to four year schools. For example, salaries of faculty in real terms have stagnated and even fallen, while those for senior professors at leading research institutions have risen substantially. Incentives systems generally have favored an increase on emphasis on non-undergraduate activities such as funded grant research. Research garners national reputation when it is high quality, via scholarly publications and even media dissemination. Stories about effective undergraduate instruction tend to be localized in nature, and do little to enhance national prestige as measured by the *US News & World Report* survey or other rankings. It is a sad but true fact that at most American universities, faculty prestige runs inversely with faculty teaching loads. Research universities use more and more relatively cheap adjunct professors and teaching assistants to instruct lower division undergraduates at relatively low cost, while showering resources on advanced graduate students and research, not to mention a burgeoning administrative bureaucracy.

Affordability to Society

A greater proportion of our national resources are going to higher education, by far, than in, say 1960. That is to be expected given rising educational aspirations and increased college participation, and even today only about three cents of every dollar of output goes to higher education. So by most ways of looking at things, America can afford the costs. At the same time, however, higher education does not exist in a vacuum. State governments have significantly reduced institutional subsidies for a variety of reasons. The astronomical rise in Medicaid costs makes it unlikely that this trend will reverse anytime soon. Huge federal budget deficits and what many regard as excessive spending growth over the past few years produces a climate where there will be strong resistance to radically expanding federal aid.

The enrollment share of private schools, counting the for-profits, is growing, and the public enrollment share is declining. Moreover, many schools that are “public” are increasingly moving in the direction of privatization, with some flagship American state universities receiving only 10 or 15 percent of their budget from state appropriations. The fiscal history of the United States for a third of a century suggests that a political equilibrium is reached in the typical state when state and local taxes are at 10 percent of personal income – less than that, the political forces demanding increased governmental

services often prevail, but beyond that the forces demanding relief from high taxation often are politically successful. The aggregate state and local tax burden has remained remarkably stable (around 10 percent of income) since at least 1970. It is probably unrealistic to expect voters agreeing to higher taxes to fund higher education, regardless of the entreaties of the university community.

This raises the question, “who should pay for the universities?” That answer may vary somewhat by type of institution – for example, it is probably unreasonable to ask current students to subsidize to any major degree long run basic research efforts at the major research universities. But should the government or philanthropic institutions substantially subsidize the education of, say, students from relatively affluent homes that do a mediocre job in school, lingering around at partial public expense for five or six years? I question whether that is a luxury that we can afford.

This gets to the critical underlying issue: are the services of universities and colleges public or private goods? Do the benefits accrue to the students in attendance, or to society at large? The question is complicated by the fact universities perform multiple tasks – disseminating knowledge to students, expanding the frontiers of knowledge through research, not to mention such non-academic functions as providing food, lodging and entertainment (e.g., college athletics, theater). It is at least plausible that it may be that positive spillover effects justifying public funding are more prevalent in some activities, e.g., scientific research, than in others, e.g., student instruction, research in the social sciences and humanities, intercollegiate athletics.

Universities claim, with only minimal solid evidence, that they are important in promoting economic development. It is unquestionably true that advanced economies need lots of “human capital” and that a basic intellectual infrastructure is necessary for major technological innovation. That does NOT prove, however, that spending NEW or incremental dollars on higher education will have a high payoff. My own research with respect to state government appropriations suggests that it does not, and hints that the positive externalities or spillover effects present in public goods may not be present in higher education today at its current level of funding and with the current system of delivering educational services. I may be wrong, but the empirical basis for claims to the contrary is pretty slim.

One factor in declining governmental support at the state level for higher education is a growing sense that the independence of universities, granted to insulate them from political pressures and allow academic freedom, may have bred a decline in institutional accountability. Who watches the universities? How do you even evaluate how they are doing? Often it seems universities embark on missions on their own and expect society to pay the bills. They do not require either legislative action or stockholder approval for most of the things they do. Thus teaching loads fell over time not because of a conscious national policy decision to lower them to support research, but because universities simply did so, almost by stealth, over a period of decades. Undergraduate instruction received less attention not because of public policy decisions, but because of

institutional actions favoring more prestigious graduate programs, research, intercollegiate athletics, etc.

Groping for Solutions: Some Ideas

It is mathematically impossible for the costs of education for students to rise faster than family income on a sustained basis (costs *can* rise faster than inflation almost indefinitely and have in some areas of the fine arts, as William Baumol has argued). Therefore, even without Commission action, some move towards lowering the tuition cost explosion is inevitable.

I think a sharp slowdown in the growth in federal aid programs would help reduce the growth in tuition costs. I think also that institutional efforts to increase merit-based assistance relative to need based aid has added to the access problem, although it must be acknowledged that many underrepresented groups are largely underrepresented because of poorer academic performance at the K-12 level rather than economic access barriers.

A revamping of federal student loan programs seems warranted. Loan eligibility should be restricted more. Students from higher income families should not receive federally subsidized assistance. Poorly performing students should be subject to loss of aid. Also, just as we now put time limits on welfare payments, we should do so on loan eligibility – perhaps four years for full time baccalaureate students. At the same time we should increase assistance for lower income students to minimize access problems. One approach would simply be to increase the amounts available for Pell Grants. An alternative, perhaps more promising approach would be to convert Pell Grants into Equal Opportunity Scholarships working like vouchers, where awards are made to students usable at any accredited institution of higher education. Encouragement should be given to states to convert more of their higher education support into grants to students rather than to institutions. This should increase somewhat competition for students, perhaps reverse the relative neglect of undergraduate instruction, and simply make explicit what is already happening: the move towards privatization of state-supported institutions. Vouchers could be both performance based and progressive – more to low income kids, more for good students than bad.

It may be possible to restructure federal tax policy in a revenue-neutral way that would better support national educational objectives. People take tax deductions for contributions to non-academic enterprises at universities, like athletic facilities. Rich schools with predominantly affluent students and annual endowment income exceeding \$50,000 per student, such as Harvard and Princeton, receive gifts treated the same for tax purposes as schools with almost no endowments serving predominantly lower or middle income students. Perhaps deductions to “rich” schools should be restricted, and donations to poorer schools (public or private) be encouraged, possibly by the use of tax credits. Perhaps a National Scholarship Foundation should be created funded by tax credits financed partly by restrictions in tax write-offs for gifts to extremely affluent schools or for non-academic purposes such as stadium renovations. Along the same lines, to improve access perhaps we should restructure governmental assistance to aid lower cost

schools that clearly use incremental funds to increase capacity. Per student costs can be reduced significantly simply by shifting the mix of students more to lower cost institutions.

Barriers to entry into offering education services should be scrutinized. Recently, for-profit schools have begun buying up small not-for-profit schools mainly to obtain accreditation. Accreditation is costly and excessively input rather than outcomes based. Admittedly there are trade-offs here: loosing accreditation rules increases risks of non-legitimate diploma mills not only existing, but obtaining federal funds for their students.

More radically, perhaps we should encourage (require?) universities to separate their teaching and research functions. Professors would work for the University of Michigan for instruction, and for the University of Michigan Research Institute for their research. This might lead to improvements in the transparency of university finances, and could ultimately lead to a new research model. Perhaps we should also revamp federal research grants, making them more purely competitive instead of grants given to monopolists (the sole proposers of a research project) based on some sense of merit. A standardized and simplified national overhead policy for research also makes great sense.

The Academic Arms Race of spending more and more to obtain higher rankings on the *US News & World Report* and similar surveys should be discouraged. How? One approach is to offer new ways of evaluating university quality. For example, administer an entrance and exit general education test at all schools accepting federally assisted students, similar to the NAEP examination used at the K-12 level. One possibility is the new Collegiate Learning Assessment test developed by the Rand Corporation and already used at over 120 colleges. The federal government would then publish the “value added” at each school. Accreditation could be more tied to this outcomes-based measure. This examination, depending on the nature of test used, might also have the secondary benefit of dealing with an abysmal decline in knowledge of basic facts about our heritage, encouraging schools to beef up their general education curricula and take seriously a U.S. Senate resolution to require some study of history in college. To deal with another national higher education malady, federal assistance could be barred to schools where the average student grade for the total student population is above, say, a “B” average. Grade inflation has contributed to declining standards and needs to be addressed.

Some rewards should exist for schools that hold the line on costs, and take cost-cutting seriously, for example by using technology more intelligently to reduce costs. What would happen, for example, if the federal government awarded \$1 billion annually to schools in the top 10 percent of institutions in terms of meeting efficiency criteria (e.g., changes in expenditures per student, most incremental value added per dollar spent, etc.), with the stipulation that 10 percent of the funds would go to efficiency bonuses to key employees? At the moment, the pressures are intense from tenured faculty and powerful deans for university presidents to recommend big budget increases. Those pressures should be counteracted by incentives to economize.

These are just a few suggestions to “whet the appetite” for discussion of serious reform.