Finance and Affordability: The Economic Drivers in Higher Ed

You are listening to Higher Ed Now, ACTA's podcast on issues and higher education. I'm your host, Christine Ravold.

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Christine: It's no secret that Americans are concerned with the cost of education. Calls for free college and student loan forgiveness often intersect with the greater desire for accountability and educational quality. How should these important issues be handled when education is still considered the best way to improve mobility in America? This week, we welcome AEI Resident Fellow, Jason Delisle, and Policy Analysis, Preston Cooper, to the show. Jason and Preston conduct research on economic factors that effect higher education. They may be able to shed some light on the economic current shaping this sector. Jason, Preston, welcome to High Ed Now.

Jason: Thanks.

Preston: Thanks for having us.

Christine: So I think we'll just ask the one really big question. Why is higher education so expensive?

Jason: Well, yep, that's the big question. [*Laughs.*]

Christine: And you have a really simple answer for it, right?

Jason: Yeah. I have a really quick, simple answer. Someone once told me—they had a great response to this and I'm going to shamelessly take it for this quick answer—which is: because college degrees are valuable and only colleges can sell them.

Christine: Okay. So we want to get into regulatory capture already? [*Laughter.*]

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Jason: I guess my more…. I have some more, sort of, slippery answers on this and, you know, I often point out that I think people are actually pretty surprised at how subsidized tuition actually is and how costs are actually quite a bit lower than what people expected, in terms of the prices that they pay. I'll be careful to separate out cost versus price, and I think we're talking about price. "What is the price that people are asked to pay for college?" It's a median tuition at a public four-year university, it's a median net tuition after all student aid, but not student loans, is somewhere around four-thousand dollars a year. Again, that's before student loans. So that's too much for some families but, I think for generally in the conversation about, "Why is college so expensive?", well, four-thousand dollars a year for tuition doesn't really jive with our notion of, "Wow, that's really expensive." Now I'm talking just about tuition here. Right?

Christine: Not about dorms. Not about fees and books.

Jason: Right. And that's because tuition is the instructional part. That's the instructional costs. This is what people are paying for in terms of the actual education, and it is the part that the University generally has control over. Why does it cost so much to just live? Right? Why is the cost of living what it is? You know, it really doesn't have anything to do with the politics and the economy of higher education. It does a little bit if you're talking about a residential four-year college and their expensive dorms, but that is increasingly a small share of the types of people, the types of educations they're pursuing. They're living off-campus. They're living at home. But yes. The living expenses are big. Median living expenses for someone pursuing a four-year degree full time, it's about thirteen thousand dollars a year. So when people say, when they're talking about the price of college, they're doing this "all in" tuition and living expenses. But I think it's important to separate out the two to get a better view.

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Christine: What do you think, Preston?

Preston: Yeah. Well, I think Jason was right to bring up the distinction between price and cost. And cost can often be a lot higher than the actual prices that students are paying. I'd say, one of the simplest reasons, which maybe is a little bit of a dodge, is that college is expensive because colleges can get away with it – because an education is valuable. A lot of people want it. And people are going to pay high prices for it. Often, that's enabled, in part, by the fact that we do have a fairly generous student loan program, particularly for graduate students and for parents – can borrow unlimited amounts through that. And part of it is also that a lot of colleges, they have a very powerful brand. A lot of them are very selective and if you're rejecting a lot of students, that means the price that you can charge the students who you do accept is going to be pretty high because if a student doesn't want to pay it, there are still a lot of students who are ready to take their place. And the cost can vary a lot. What Jason said about the four-thousand-dollar price for tuition at public colleges is absolutely true, but the costs of those public colleges, the overall costs, can be a lot higher.

Christine: I may push back a little bit. My research tells me that the average student loan balance for the class of 2016 is around thirty-seven-thousand-dollars. This four-thousand-dollar tuition mark and these much larger student loan balances, where's some of that coming from?

Jason: Those are students that are going to borrow for four years. So we're talking about the annual tuition costs, so the loan amounts and the thirty-some-thousand dollars is what someone is borrowing at a four-year college, so we're not talking community colleges. We're not talking certificates. So a four year degree: they're going four years, sometimes longer as we all know.

Christine: You're little secret?

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Jason: And they're also borrowing for living costs. Right? And, by the way, that's of the people who borrow, that statistic, that thirty-some-thousand dollars. So they're about forty-some percent of people who leave with a four-year degree without any debt whatsoever and that's a statistic we have to remember too, that they're a lot of people going and not incurring any debt. So yeah. Thirty-seven thousand now. I think it's important to point out that strangely, with student debt, we are very fixated on the balance and not on the monthly payment. The trick I usually play with people is I will catch them and I will ask them if they have a smart phone. And they say, "Yes." And I say, "Well, what do you pay for a smartphone service?" And they, "Fifty-dollars a month." I say, "Why did you say 'monthly?'" Like, "How else would I think about it, right?" I think, "Well," and this is my point with the student loans, like it's important to think about what people are paying per month as a share of their income towards the degree and is it affordable? And there's some good evidence that, despite that number which might sound very high to people as a share of someone's income who has a bachelor's degree, the monthly payments are pretty affordable.

Preston: And they've remained pretty constant over time. The median monthly payment I think is about three, four percent of your income and it's been that way since the 1980s.

Jason: That's right. But the really big debt – No. I don't want to make light of a number if someone… and again, I think the student debt number is right so the number you cited is for someone who finishes, and I actually think that's not where the concern is.

Christine: It's the people who don't finish.

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Jason: The concern around student debt is for the people who don't finish and they're the ones that have maybe five or only ten thousand in debt. So the really counterintuitive thing with student loans and college costs and value is that the people with the least debt are the ones most likely to not pay. The ones with the most debt are the ones most likely to successfully repay because they got the credential, which shows it's sort of worth it. The system kind of works. Where it's not working is the people who don't finish. That's actually an area where—it's not something that we talk about very much in the policy world is "What do we do about…?" I mean, there's over eight million people in default on their federal student loans. My sense is that the vast majority of them are people who dropped out and that's just a group that the policy world is not interested in for whatever reason. I mean, there are many but it's not interested in dealing with that issue.

Christine: Well, I'd say that's kind of where ACTA comes in because educational quality definitely has a role to play in people being able to complete their degree and being able to find a good job that enables them to repay their loans after they've graduated. So some innovated programs have started to address the issue of not just admission but retention and eventually getting to completion. I think our best-practices manual had some really interesting ideas about keeping students on track, knowing before the student is off-track, that they could be in danger of falling behind.

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Jason: Yeah. And there's a big tension here that we have in our system. We're working on a project, in the middle of a project right now, around international systems of higher education – comparing ours to theirs – that kind of approach. One thing that is very important to us in our system of higher education is this notion of open access. We like our second and third chances. And we like that everybody is able to go, and there's an open access institution that they can enroll in. You have to remember in other countries, they don't necessarily have that same kind of approach. They have a, sort of, gate-keeper that might say, "Aw, you don't make the cut; you don't make the grade." Right? And then you have less of these other problems of some of the dropouts and the degrees aren't worth it – those kinds of issues. So it's an important trade off to bear in mind – that because we value the second chance in open access in our system, we need to think harder about the consequences of the dropouts and the lack of completion.

Christine: That's important to know. But you don't want colleges taking advantage of that dream and the idea of open access and then treating unprepared students as just a one-semester source of revenue and doing nothing to get them across the finish line.

Preston: It's also worth noting that there's a bit of a tension between attainment and affordability in costs. I think a great example of this is what happened in the United Kingdom in the 1990s when they went from a free college system to a system with tuition fees that repaid over the course of thirty years as a share of your income. And attainment and access for low income students actually went up after they started charging tuition and that's because the universities there started having more resources with which to help those low-income students across the finish line. That's just one tradeoff that we need to be aware of. Other countries have negotiated it one way. We've negotiated it one way. But there is a tension there.

Christine: Preston, I seem to recall your proposal to have insurance policies for basically income share agreement for colleges as an accountability measure?

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Preston: Sure. So what I proposed was that colleges, when colleges close or when colleges are found to have committed fraud, the government usually has these programs in place to discharge some of the student loans that students took out when they went to the college. If your school closes while you're an enrolled student there, you can get your loans cancelled. This happens for a big, let's say, for-profit chain like ITT Tech or Corinthian, then that can add up to several hundred million dollars that taxpayers are then on the hook for. So my proposal was to have colleges essentially be required – if you want to participate in the Federal Student Loan Program, if you want to get access to all this taxpayer money, you're going to have to purchase insurance, which will then cover the discharges of student loans that might happen if you were to close or if you were to be found guilty of fraud. And this would kind of add a market check into the higher education system because no insurance company in their right mind is going to provide insurance to Corinthian or ITT Tech and, if they do, they're going to do it at a very high premium [*",,,nose bleed prices."*] at very, very high prices and it's going to kind of provide this natural market-based system to weed out some of the bad actors.

Jason: Gee, Preston. You don't think the insurance company would says, "Wow, they're accredited." [*Laughter.*]

Christine: You just brought me to my next point, which is accreditation is supposed to be a quality assurance measure where we talk about it as a good housekeeping seal of approval. But there are thousands of accredited colleges in this country for profit and nonprofit that have terrible graduation rates, over four years, and very bad graduation rates over six years. And students really can't use accreditation as a market signal for quality at all. So how do you think we can correct for the lack of quality indicators?

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Jason: Yeah. This is a topic that the policy circles in DC goes by – by the name of risk-sharing. It's the idea that when students take out loans at a school, that if they don't repay the loans, then the school should be on the hook for a portion of that risk. So this is the risk-sharing. And there's a lot of talk and there's some bipartition interest creating a policy like that. We don't have a policy like that right now in the Federal Student Loan Program. There's some interest in doing that and making it apply to all types of colleges and universities – not just for profits. And so there's talk about, "How would you make it work? What would it look like? What are the terms? How broad would it be?" But actually, that's kind of putting the cart before the horse because I think there's sort of a political tension here. Right? And this goes back to my point about the access. My sense is if you did a risk-sharing regime, that you'd have a lot of community colleges that would get dinged under a risk-sharing system because they're open access. A little bit to their defense, the community colleges might say, "Well, I can't deny enrollment to any of the students and I can't deny them a loan either. And then they go and they don't repay. And I probably knew that on the front-end, but I couldn't say 'no.'" And so I think the politics around finding community colleges is going to be pretty ugly, so I think we need to have more frank conversation about the politics of risk-sharing. "Is this what we intend to do? Do people understand where that policy is headed?" That's an important thing to talk about. It's not just for-profit colleges where we have bad outcomes.

Christine: No. I remember when the Obama administration wanted to do college rankings. I believe the HCBUs objected to that strongly because they have a greater share of students from underserved communities to begin with.

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Jason: Yeah. And HCBUs, you do community colleges. There's also—the Obama administration found itself in a tough spot when they wanted to do rankings and abandoned it because they said, "It turns out our higher education system is really diverse." And they said, "So it turns out it's going to be really hard to rank anything in such a diverse system. The judgement call would be too difficult because higher education is supposed to do lots of different things for different people in this country." I think a risk-sharing system will bump up against those same sorts of values and complications. Actually, one interesting thing, though, has been watching the needle move a little bit around the gainful employment regulations that the Obama administration put out, that we would value the degree based on someone's earnings. I'm sure many of your listeners perhaps would bristle at the notion that we would judge the value of the degree by how much someone earns.

Christine: Well, no. We're a liberal arts organization so we put as much value on a philosophy degree as an engineering degree in terms of the positive externalities to communities and culture and the life of the minds, generally.

Jason: Yeah. And so this has been an interesting shift to watch people say, "I think we should judge it based on the earnings. And we want earnings data to be out there," about these degrees. And from the Obama administration, "We want to hold the institutions accountable based on the earnings." And I would challenge the few who have said that. I said, "I'm not saying I necessarily agree with this, but isn't there more than earnings?" Mark Snyder, a colleague of mine, has a very good retort to this. He says, “There may be, but we do price tuition in dollars.” [*Laughter.*]

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Christine: And as soon as you start talking about education as an investment, you want a return.

Jason: Yes, exactly. And this is what the students say they want. This is why they’re going. And so I just think it’s sort of an interesting observation that the needle is moving there. If someone shows up into that argument and says, “Well, I think earnings isn’t the be all, end all. There’s more to an education than just that.” I think that argument is getting less and less traction.

Christine: We like that argument here. But our listeners frequently are trustees and they have the power to affect policy on an individual campus level, so maybe we should advise them what they can do on their campuses to address academic quality, affordability and access concerns.

Preston: Well, one big thing that trustees can do and the colleges can do that the federal government is currently not doing is providing data on outcomes at the program level because so much of the variation in outcomes, whether it’s on earnings or graduation rates, does happen by what you major in or by what field of study you participate in. And right now, the college score card that the Obama administration put out, which we talked a little bit about earlier, just provides that data at the institution level. There’s been some movement towards providing more data at the program level with the gainful employment rule and others, but when students are going to college, the choice about which institution to go to, which college to actually go to, is very at the forefront of their mind, but there’s not a whole lot of information out there to help them make a good decision about what they're going to major in or what sort of field of study they're going to pursue.

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Jason: Yeah, and to be even more specific in what trustees can do, colleges and universities are coming around to this idea of that having earnings and outcomes data more available is in their interest. Not all of them, but they're coming around to it. There're a lot of law makers, thought, at the federal level who are not so sure on this. They think this is over reach.

Christine: None of the trustees decide to do it themselves. It could be a very interesting marketing tool for a university.

Jason: Well, I think what they have to do, though, is they have to say they want it. I'm not sure the institutions themselves can get the information that would be good and reliable, and that is where the federal government comes into play here. It's uniquely situated to get the information on earnings in a way that a university is not …. They could do surveys. They could ask people to provide the information. Maybe if it's a state university, they could get it from the state government. But it's going to be data with a lot of holes in it. So it's more of letting law makers know that this is important information that they want.

Christine: I think that goes back to that proposal earlier this summer to ease up the transparency – the student confidentiality for student unit records.

Jason: Yes. This whole debate has kind of taken on the term of the student unit record, which sounds kind of scary. There's a big advocacy move around having a federal—essentially—data system that tracks information about students as they move through the system, and then that would be the system that provides this information on outcomes and earnings. I think that's kind of become of become the litmus test on "Are you for this?" "Are you for data and transparency or are you against it?"

Christine: Well, there were major privacy concerns that other people are weighing and throwing some interesting lines about who's for and who's against.

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Jason: Yes, mostly among, I think, the republican lawmakers who are on Capitol Hill from my conversations. There's more of a divide there than I think there is among the democrats. But I think the conversation around a student unit record as the approach to getting the information out has stifled a little bit of thinking around: "What are other ways that the federal government can get this information out in a way that doesn't compromise privacy, but also isn't one that is…." I mean, the Obama administration, to a little bit, sort of poisoned the well on this because when they set about creating their scorecard, they said, "We want to hold institutions accountable and we want to tie federal dollars to the outcomes," which is….

Christine: …performance based funding.

Jason: It's performance-based funding and, if you're sort of a small government conservative, you hear things like that and you go running away. And so I think that that's got that design of what data and transparency is in people's minds but there are other ways to do it that don't lead you down the slippery slope of tying dollars to outcomes. Because, you know, for the free market minded policy folks, that the idea of the federal government deciding what is a good program and what is a bad program and funding it accordingly, is a bit terrifying. This is picking winners and losers in the economy using the government's money.

Preston: But the great irony there is that, if you're going to have the consumers actually pick it and they don't have good data off of which to make that decision, then the market system kind of breaks down.

Jason: Yes. And Preston's totally right. And I think that both of those things are correct and you can have both of them, but it's this getting the policy makers to sort of understand that, that they want to be for getting the data out so the market can work better but, in a way, that doesn't lead to a major overreach.

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Christine: So a little bit earlier, you're talking about the deceptively low price of college tuition. But the reality for a student enrolling is still pretty daunting. Earlier this summer, we also released our administrative cost guide looking at the ratios between administrative spending and instructional spending at different Carnegie class institutions, so it's pretty large averages we're talking about here. What can trustees do on their end, on the financial end, to make this more affordable for students? We have a transparency angle that could really improve students experience, but what can we do on a financial side?

Preston: Well, there's no silver bullet solution on the financial side.

Christine: Come on, Preston. [*Laughter.*]

Jason: Some day I'm going to be in Washington and somebody's going to get a question like this. And I'm going to go, 'Well, here's the silver bullet." [*Laughter.*] I'm still waiting for that day.

Christine: But you have to be ready.

Preston: There are a number of broader trends in higher education that have accounted for the higher costs that we've seen in recent years. Part of that is administrators, that we do have more administrators per student. Part of that is on the instructional side, that professors are generally teaching fewer hours per week than they have been in the past. I think the reality for each individual university is different so I can't really make a recommendation about, "Here is the broad macro trend that we need to attack." But I would say trustees should take a look at their own university's balance sheets and make the decisions accordingly.

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Christine: Georgia and Florida both had a pretty good initiative to just make sure that their classrooms were in use on Fridays. They found that there's a pretty big decrease in the space utilization. So we're building all these new buildings but current infrastructures are already underutilized.

Preston: Yes. Looking for efficiencies like that, I think that's a great idea. You know, it's interesting that you mention Florida because I've seen in the news lately that Florida's been putting some more money into its public universities. But instead of using that money to lower tuition, the Florida public universities are using that to hire a bunch more faculty in the hopes of getting their faculty to student ratio down a little bit. And I would say, if you ask students, "Would you prefer to have two fewer students in your class or a reduction in tuition?," I think most students would take the reduction in tuition. So it's decisions like that that are going to have to be made that probably trustees can play a role in.

Jason: Yes. I think that's a good example here that we do tend to talk a lot about the cost of college in a way that almost implies that this is the main thing that drives peoples' decisions about whether or not to attend and where to attend. But that example there shows that there's a range of factors on which people make their decisions on where they're going to go and also what the universities spend the money on. But your point that the university receive more money and, rather than lower tuition, chose to do something else with that is kind of getting back to this other issue of, like, “Why does college cost so much?” What we opened with. Which is that the universities, in some ways, they’re prestige changing. Right? The first thing that they think they want to do may not be, “How can I deliver the biggest bang for the buck?” And, “How can I drive my tuition as low as possible?” There’s probably a competing desire there of, “How can I gain as much prestige as possible?” and so new money goes into that.

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Christine: So we have some colleges treating themselves as bedlam good while everyone else is assuming it’s a public good.

Preston: [*Laughs.*] I suppose that that’s one way to put it. But I think Jason’s point about chasing prestige is right on the mark, that a lot of colleges out there, they follow something called the “revenue theory of cost,” which is basically that we’re going to want to raise as much money as possible and then spend as much money as possible, spend all the money we can raise. Because, when you think about it, when you’re talking about how to deliver the best quality education, you could probably justify pretty much any expense out there as necessary, as part of providing a well-rounded education. And once you’re in that mindset, then there’s basically no justification for cutting tuition or reducing the rate of tuition increase. All of the money has to go into whether it’s hiring more faculty or hiring more administrators or building more campus infrastructure. There’s never a shortage of potential expenditures that you could technically ascribe to producing a better-quality education for the students.

Christine: Including nap rooms and climbing walls.

Preston: Yes. Including climbing walls and including lazy rivers and all this nonsense we read about. So I would say part of it's got to be breaking that mindset in thinking about, 'We're not just chasing prestige. We're not just chasing the highest level of expenditure possible. We are players in the economy and we do need to think about whether that marginal expenditure is really justifiable.

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Jason: Back to the point of, in the case of public universities, law makers fund their public universities with appropriations for a lot of different reasons, not just keeping tuition low. I was just reading a piece—I think it's John Marcus who wrote it—about the midwestern universities. The research universities are sort of being starved for money and the legislatures aren't funding them enough. So here the concern is just around research. They're not doing enough research and their research prestige. So on one day we can be concerned about tuition, and then on another day, we can read a whole different story about how their not keeping up with their research. So there're many reasons, many different things that universities do and would be demands on their budget in addition to just keeping tuition low.

Christine: Which brings us to more disruptive ideas. Like should we unbundle all of this? Make colleges just about the undergrad and leave research to privately funded think tanks, or make the research universities less responsible for other aspects of education?

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Jason: I'm not really sure on that. I'm not sure what the exact answer is just because I think that many people believe that the value of the university is in its brand, which comes from some of the research it does. Right? What's really interesting about how we should do this differently, you think about these conversations four or five years ago—basically at any point. For the past fifteen

years, we've been having these conversations about the thing that's going to come along and kill college. Then everybody's excited about it. A few years ago, it was MOOCs. Before that, it was online. "Everything's going to be online." All these things seemed to fizzle.

Christine: Well, maybe at the margins they can accumulate.

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Jason: They might absolutely. I'm not saying, "We're doomed to be in this model forever." But it's important to realize that a lot of those things have yet to make a serious dent. In fact, one of the biggest ironies on doing education online in that everyone thought this would lower costs. This would lower costs and lower prices. What we're seeing is it's probably lowered costs but it hasn't lowered prices where you're seeing universities going out and building big online platforms and then they're charging regular tuition for it. It's not necessarily a really cheap alternative because, perhaps, they don't have a big incentive to sell it at a price below what people are willing to pay.

Christine: Preston, can we go back? You were kind of talking about a U.K. program that sounded a lot like an income-share agreement. Is this going to be something, that we're already excited about, Purdue's back-boiler program? But do you see more momentum?

Preston: Yes. So the U.K. programs, they have tuition charges in the U.K. They moved away from the free college model of the 1990s. Now you basically repay those tuition charges over, I think, thirty-years now as a share of your income. And I'm very excited about income-share agreements. I'm really excited to see where the back-boiler goes and I think that could be a promising model for some other colleges to follow in terms of keeping tuition more affordable for students. I would say, when it comes to paying back student loans as a share of your income, one problem with the student load market right now that prevents private lenders from making student loans, especially at the undergraduate level, is that there's no collateral, essentially, the way that you would have collateral with a mortgage where you put up your house as collateral or with a car loan where you put up the car as collateral. So why not have the student's future income as collateral. If you make more than you're expecting, then you're going to pay back more through the income-share agreement. If you make less, then you're going to pay less. But if the lender prices it right, then eventually they should come out ahead or break even. So I would say income-share agreements are a pretty promising way to take care of that market failure that we have seen in the private student loan markets. They could be done by private lenders. They could be done by the universities themselves, such as Purdue. I don't want to oversell them too much but I think that is an exciting model that we should look forward to in the future to see what's going to happen with that.

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Jason: To pick up on the U.K. system, it's still very much so a loan, so there's a balance that you have to pay off. And it's important to keep in mind, in an income-share agreement, there is no balance. It's just a share of your income for a set amount of time. So you could pay a lot more than your balance. You can pay a lot less than your balance. But in the U.K., it's really interesting. The students who finish bachelor's degrees leave with more debt than students in the United States, and people don't seem to know this or think about it, or talk about it much. The students are leaving with more debt than in the U.S. and they're repaying their loans over a longer period of time. It's a thirty-year repayment term. The difference is that the amount they have to pay as a share of their income if fairly low. So it's really a way, I guess the way of describing it, it's sort of "deferred tuition." Everybody's paying tuition on the front end. It's just deferred and you sort out how much people pay based on their income after they leave school. We actually have a system like that in the United States where we just do

it on the front end. We take the applicants and we look at their financial situation of their families when they enroll and we say, “How much can you pay?” And the system, we charge more money to people who can pay more. So the parallels between our system is theirs are pretty significant and usually people are trying to draw distinctions, but I think they’re quite similar.

Christine: When you put it like that, it’s pretty easy to see the similarities in how the U.K. and the U.S. are paying for college. But there is a pretty big difference in how much each country spends on higher education.

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Preston: One data point that I do think is really interesting is that among OECD nations, the United States spends more per student on higher education than any other country in the developed world, which I think is a pretty shocking statistic. And we also spend more as a share of GDP on higher education than other country in the developed world. So if we’re talking about bang for our buck, I’m not sure the United States is doing so well.

Christine: No, not particularly well. But at least we have come up with a few ways in this podcast alone that we can address costs and reconsider how we’re evaluating the financial and economic aspects of higher education. Preston and Jason, thank you so much for joining Higher Ed Now.

Jason: Thank you.
Preston: Thank you.

Christine: To learn more about ACTA’s Project on Administrative Costs, please see our website www.goacta.org and take a look at our recent publication, How Much Is Too Much? Visit AEI’s website to learn more about Jason and Preston’s research in higher education. If you have questions or comments about this podcast, please send them to info@goacta.org. Until next time, I'm Christine Ravold and this is Higher Ed Now.

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