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The Future of Government Financing of Higher Education

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Abstract
[Excerpt] Outline of a presentation to be made to the American Enterprise Institute Conference on "Higher Education After the Spelling Commission: An Assessment" in Washington DC, March 13, 2007.

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(Outline of a Presentation to be made to the American Enterprise Institute Conference on "Higher Education After the Spelling Commission: An Assessment" Washington DC, March 13, 2007)

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I. Some Important Objectives

A. Improve Access and Persistence
   1. U.S. no longer leads the world in college completion rates – a serious problem in a knowledge based economy
   2. Inequality in college access rates by income class have barely narrowed over the last 25 to 30 years; inequality in college completion rates have narrowed even less
   3. Groups in the population that are growing the most rapidly are those that have historically been under represented in higher education

B. Improve and Maintain Higher Education Quality

C. Remember that higher education is much more than undergraduate education (not emphasized by the Spelling Commission)
   1. Importance of scientific research for innovation and economic growth
   2. Importance of graduate education for the production of scientific research and the next generation of American PhDs
   3. Role of land grant universities and public higher education more generally in improving the welfare of the nation at large

II. Government Financing of Private Higher Education

A. Primary federal role has been financial assistance to students (grant aid, loans, work study, and tax credits) and support for research.[1] State programs often provide financial support for students enrolled in private higher education institutions and in some states (such as NY), direct support to private higher education for educating in-state students or for capital facilities

B. There are enormous federal, state, and local tax subsidies in the form of tax deductions for contributions to these institutions, exemption of their endowment income from taxation**,** exemption from local property taxes, and their eligibility to issue tax exempt bonds.

C. For over a century tuition has risen at these institutions, on average, by 2 to 3.5% a year more than the rate of inflation. The factors that have led to this are discussed in my book *Tuition Rising*; they include the failure of faculty productivity in teaching to grow (explain), the quest by institutions to be the best that they can in every dimension of their activities (which has led to an arms race of spending), the widening distribution of earnings in the U.S which creates pressure for students to "buy the best" and

[1] My discussion of federal financial aid programs will be brief because Sandy Baum from the *College Board* will be discussing these in her presentation today

increases the demand for positions at selective private institutions (thereby reducing any competitive pressures to keep tuition down), the *USNWR* rankings, the belief by many that high tuition levels reflect high quality, pressure from external actors (alumni, historic preservationists, the environmental movement, and local governments) and the system of shared governance. However, the tuition increases overstate the increase in the costs faced by students because tuition discounting is prevalent. NACUBO surveys suggest that the typical private college or university gives back 30 to 40% of its tuition revenue in the form of grant aid to undergraduate students. Increasingly this grant aid is ‘merit based”, as institutions use grant aid to “craft their classes” (very few institutions, such as my own, provide only need based aid).

D. At the same time that tuition levels have continued to soar, the endowment levels at the richest private colleges and universities have also soared.

E. Why should policy makers care? No one is forced to attend selective private colleges and universities. The answer, as I have indicated above, is that taxpayers as a whole are subsidizing these institutions because of all the favorable tax treatment they receive and therefore the institutions are expected to act in the public interest. However, to justify this treatment, they have to remain accessible to students from all family income levels; currently the proportion of Pell Grant recipients at many of them is far below the share of Pell Grant recipients in the college student population.

F. The wealthiest privates have understood the situation and have embarked on programs to enhance their enrollment of students from disadvantaged backgrounds- drastically increasing financial aid packages, searching out these students, and providing enhanced support services for those who enroll. However, more generally private higher education’s feet should be held to the fire and private higher education institutions should be held accountable for the tax benefits that they receive.

III. Government Funding of Undergraduate Public Higher Education

A. Over the last 25 to 30 years tuition has risen more in percentage terms in public higher education institutions than it has at private higher education institutions. But the dollar increases have been smaller at the publics than at the privates so in real terms the gap in tuition between private and public higher education has increased.

B. Tuition increases in public higher education have been driven largely by the failure of state support per student to grow much in real terms over the period –it has been essentially flat if one uses the HEPI rather than the CPI. Financial problems faced by state governments, which I have elaborated upon elsewhere, make it unlikely that state support for public higher education will increase substantially in the future.

C. As a result, expenditures per student have fallen in public higher education relative to expenditures per student in private higher education, leading to declining relative salaries of faculty in public higher education (which makes it difficult to attract and retain top faculty) and to an increased use of part-time and full-time non tenure track faculty. Research shows that the latter is associated with reductions in graduation rates, with the largest impacts at the four-year comprehensive publics; there is no such thing as a free lunch.

D. Educational expenditures per student vary widely across types of public higher education institution; they are larger at the flagship doctoral institutions than at the masters' institutions and larger at the masters' institutions than at the community colleges. Conversely, the proportion of students who are Pell Grant recipients are larger at the community colleges than they are at the masters' level institutions and larger at the masters' institutions than they are at the doctoral institutions. So students from lower income families are more likely to attend lower expenditure per student institutions. Considerable research shows that higher expenditures per student are associated with higher post college earnings, other factors held constant, so on balance the income gain students get from attending college is correlated with their initial family incomes.

E. The disparity in expenditures per student received by students from different family income levels is amplified by the changing distribution of state financial aid programs. State financial aid programs are increasingly merit (such as the Georgia Hope Scholarship program) rather than needs based. Federal financial aid policies have also shifted away from grant aid for low income students to subsidized loans and tax credits; the latter benefit primarily middle and upper middle income students rather than lower income students.

F. The privatization of public higher education (moving towards further reductions in state support and allowing public institutions, among other things more freedom in tuition setting) is most likely to be successful at the flagship publics, which have the market demand that will allow them to raise tuition and have the ability to raise substantial endowments and large annual giving streams. The public comprehensives and the community colleges are less likely to be able to pull this off and privatization of these institutions will likely price some students, primarily lower income students, out of college.

G. The transition from community colleges, where many low income students begin their education, to four-year colleges is often not seamless and hinders, their progression to four year degrees

H. The states and public higher education institutions have responded to these pressures in a variety of ways – because public higher education is governed separately by state, forms of natural experiments arise. Among the responses

1. Programs at a number of our nations' flagship public institutions that mimic (or were mimicked by) the programs being developed at the selective private institutions- examples are Access UVA, the Carolina Covenant, and the Texas Longhorn Opportunity Scholarship Program- to increase the access and persistence of students from under represented groups

2. The provision of vouchers to students, rather than direct state support for public higher education institutions; these vouchers can be used at any public or private institution in the state (Colorado)
3. An agreement that is about be enacted into law that graduates of community colleges in Virginia from lower income families can attend the University of Virginia and still pay much lower community college tuition rates.
4. Movement to a uniform high undergraduate tuition policy with state residents receiving grant aid at least equal to the state appropriation per student that the university receives (Miami University of Ohio)
5. More freedom for public higher education institutions to raise their tuition and be freed of other state restrictions (human resource policies, procurement policies, capital construction policies) that reduce their ability to compete with their private sector counterparts in return for meeting state goals (Virginia)
6. A number of states have programs offering additional scholarships, or loan forgiveness programs, for students who work in the state for a number of years after graduation in fields that the state judges to be socially important (nursing, teaching, social work). Just as our nation's most selective private law schools have developed similar programs for their graduates who work in the public interest law area, private higher education institutions might similarly develop programs to encourage their graduates to work in lower paying socially important fields.

IV. Other Policy Issues Relating to Financing Higher Education

A. How the federal government finances Medicaid and the Pell Grant program is asymmetrical. When states spend more on Medicaid, they get more federal matching funds. In contrast, when states spend less on their public higher education systems and public higher education institutions respond by raising their tuition levels, the higher tuition levels increase the amount of Pell Grant funding that residents of the state are eligible for (Pell Grants are limited by the tuition levels students pay). Thus states get more federal funds if they increase Medicaid funding but less federal funds if they increase state funding (which allows public tuitions to be kept low). The Federal financial aid system should be restructured in a way that encourages states to spend more, rather than less on public higher education. The recently passed "Pell Grant Equity Act", (HR990) is a step in the right direction.

B. If increasing the enrollment and persistence of students from lower income families is a serious policy goal, federal and state funding should support this objective. State funding to an institution might have a component based upon the share of students enrolled from lower income families. Federal funding through programs such at the SEOG should similarly be based upon these shares, not on historical entitlements. Federal and state funding should also provide additional funding to both public and private institutions for graduating students from lower income families. As a model, the Bundy aid program in NYS provides grants to private colleges and universities in NYS for each state resident that the graduate. A program of this type that provided extra funding for graduating Pell Grant recipients would provide the proper incentive for institutions to behave in the public interest.

C. Research suggests that the social return to college education is larger than the private return. For example, a number of careful studies show that non college graduates earnings are higher in areas in which more college graduates are present and in firms that employ a greater share of college graduates. Richard Vedder has presented evidence that at first glance appears to be to the contrary; states that spend more on public higher education do not see faster growths of income than states that spend less. If this evidence is correct, a reason may be that college graduates are mobile and can migrate to wherever income earning opportunities are best. So some states, including many located in the Midwest, see large percentages of their college graduates moving out of state. This provides an incentive for these states to spend less on public higher education than is socially optimal. To the extent that we as a nation benefit from a more highly educated workforce, this provides a strong rationale for more federal investments in higher education, either directly through student aid or indirectly through incentives funding provided to public and private higher education institutions.

D. Public higher education is more than undergraduate education. Cut backs in state funding for public higher education threaten the quality of graduate education and research as well as the scope of extension activities. Research shows that graduate students in the sciences and engineering contribute to research and that research is associated with innovation and increased economic growth in an area. However, because PhDs are even more mobile than undergraduates, states have an incentive to under invest in graduate education. The case for more federal funding for graduate education (such as that proposed in recent House legislation) is strong.

E. More and more public higher education is viewed as a vehicle for economic development by public policy makers and state funding to public higher education systems often comes in the form of support for research infrastructure rather than support for the core budgets of the institutions. This puts further pressure on the quality of undergraduate education at these institutions.

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