INSIDE HIGHER ED

Views

The Real Cost Equation

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By **Robert B. Archibald** and **David H. Feldman**

Since 1981, the list price tuition and fees charged by American four-year colleges and universities (public and private together) has risen at an annual rate of 7.1 percent. Room and board has gone up 5.3 percent per year. Overall inflation has averaged only 3.2 percent. These differences have fueled an increasingly acrimonious public debate over the causes and consequences of the rising cost of college attendance.

At some risk of oversimplification, most of those who write on higher education start from the proposition that the causes of rising college cost are to be found by examining higher education with a fine-toothed comb. What they find isn't pretty. They see dysfunctional universities in an increasingly dysfunctional higher education system. From there, the descent into apocalyptic rhetoric is easy. As a recent editorial in the ***Economist*** says, "America's universities lost their way badly in the era of easy money. If they do not find it again, they may go the way of GM."

The strands of thought that indict higher education are quite varied, but many rest upon the notion that public money has indeed been too easy to obtain. In simple supply and demand terms, federal financial aid increases demand, and this pushes up price. William Bennett, while serving as President Reagan's education secretary, famously titled an op-ed **"Our Greedy Colleges"** and linked federal largesse with tuition hikes. Easy money also supposedly fuels prestige competitions among colleges and universities as they compete for rungs on the ratings ladder.

Another strand of the dysfunction narrative focuses on the gold plating of the college experience. In this view, colleges spend far too much money on lifestyle amenities. The criticisms fall on things as diverse as career advising centers, psychological counseling, and plush exercise rooms. Room and board is a lightning rod since it is itemized on the bill. The gold plating argument often contains a strong aesthetic revulsion over "country club" colleges coupled with a wistful nostalgia about a supposedly simpler and more Spartan past.

Lax workplace culture at colleges and universities offers yet another fat target. Tenure is a common punching bag. In different tellings of the story, the faculty either does not work hard enough, or alternatively works too hard on the wrong things – research at the expense of teaching. Faculty governance often is fingered as a problem since it supposedly allows the professoriate to dictate the terms of its own employment. These workplace culture arguments often are augmented by politicized attacks on the type of research done by many professors in the humanities and social sciences.

Lastly, statistics indicating that administrators and support staff have grown as a percentage of the higher education workforce supposedly offer even more evidence of rising inefficiency. Over the past 20 years, as enrollment has grown by 40 percent, the number of support-staff members on campuses has doubled. This is often taken as prima facie evidence of bloat and inefficiency.

On the other side are those who pine for a lost past of generous government support, especially from the states, that enabled public universities to offer high-quality programs at very low tuition. In this view, public policy over the past 30 years has forced up tuition and threatened both the mission and the quality of our great public institutions. Many a newspaper editorial has chastised state legislatures for their shortsightedness, as though good arguments about the social importance of higher education somehow will help today's political leaders to learn from past mistakes.

All of these arguments place the higher education system at the center of the universe worth examining. Holding up a magnifying

glass to the industry can indeed yield a wealth of detailed information, but without context that information is partial, and it can be quite misleading. The college-centric view of the world all too often lends itself to an easy politicization of complex issues. Before we jump on the apocalyptic bandwagon, there is mileage in placing the higher education industry firmly within the industrial structure of the American economy and within the economic history of the past century.

In our book, titled ***Why Does College Cost So Much?,*** we attempt to supply this context. Instead of using a magnifying glass, we take an aerial view of the industry. In the view from above, the most important drivers of college cost are the technological forces that have reshaped the entire American economy.

Our technology story is a tripod with three strong independent legs. First, higher education is a service industry. From 1947 to 2009 the average annual price increase for services was 4.0 percent, while for goods the average annual price increase was only 2.4 percent. Economists have understood why this happens for a long time. Technological progress has not reduced the number of labor hours required to provide most services. By contrast, technical innovation has significantly reduced the number of labor hours and kilowatts of power needed to produce most manufactured goods and agricultural products. As a result, the cost of a service such as a year of college must rise compared to the price of a basic car or a basket of groceries.

This is the well-known “cost disease” phenomenon. We think most contemporary critics of higher education fail to credit this argument’s real power in explaining the time path of higher education costs. The artisan nature of higher education certainly explains the past. And while the arrival of distance education changes the learning experience, quality programs rely on providing strong interaction between professors and students. As long as this is what people value, college costs will tend to rise faster than the overall inflation rate.

Higher education also shares with many other personal services a reliance on a highly educated workforce. In the late 1970s, the wages of highly educated workers began a sustained rise. All personal services that rely heavily on this sort of labor have experienced a surge in costs. This is actually hopeful, since there is no reason to believe that this trend must necessarily continue. In fact, if the United States could do a better job of funneling college-capable students through the system, the increased supply of college-educated workers could ameliorate this part of the problem by reducing the rate of increase in salaries.

Lastly, technological change does affect higher education directly. But instead of reducing the number of labor hours it takes to produce a class, new technologies alter what we teach and how we teach it. To take but one example, the contemporary physics student must be familiar with current tools that define a modern physics laboratory. These tools are more expensive than the chalk and blackboard world of the past. Just like modern medicine, colleges and universities must meet a standard of care, and that standard is set in the labor market that will employ our graduates.

We take the dysfunction narrative seriously. Some of its arguments hold together as coherent stories, while others fall apart when probed more deeply. Yet taken together, the dysfunction arguments fail to explain the data on college cost and price nearly as well as simpler and more general arguments that flow from our aerial view.

Consider, for example, the claim that rising numbers of administrators per student is clear evidence of waste that needlessly drives up college cost. Like many other businesses, over the last two decades universities have shed most of their typists, replacing them with a smaller number of IT specialists. Replacing “clerical workers” with “support staff” raises the fraction of the employee base that is “administrative.”

Colleges also have more administrative staff working in areas like career services, counseling, and health care, to name a few. Those workers aren't producing additional college graduates, so the ground is laid for more charges of unproductive waste. But that reflects how researchers choose to measure output or productivity more than it does any objective measure of inefficiency.

The gold-plated dorm argument often begins from a simple observation that dorm rates are rising faster than apartment rents. The problem with this comparison is that data on apartment rents are adjusted for rising quality (like increased square footage and more bathrooms) while the data for dormitories are not. There is no evidence whatsoever that *quality-adjusted* room and board prices are going up any faster than their private sector counterparts. This issue is not hypothetical. Over the last 40 years the American standard of living has more than doubled, and the quality of the American housing stock has improved substantially. The standard of what families expect in student housing and dining has evolved as well.

Lastly, the claim that government subsidy simply raises cost by pushing up demand is based on a misunderstanding of basic economics. The notion that rising demand leads to rising price relies on the assumption of an upward sloping supply curve. Yet there is a wealth of evidence that the long-run supply curve for a college or university is flat.

There are indeed higher education-specific reasons for why list-price tuition has risen, but not all of them are nefarious. When state government finances are troubled, public universities face a choice between allowing quality to decline and raising in-state tuition to

compensate for public cuts. Landing on the side of tuition increases suggests an affirmative choice for maintaining quality.

Likewise, another force for rising sticker-price tuition is the increasing amount of tuition discounting done by public and private universities alike. This increased tuition discounting is in part an institutional response to growing income disparities in the nation, disparities that are not well addressed by public financial aid programs.

We do not argue that colleges and universities are particularly efficient organizations. But we are not persuaded that rising inefficiency offers a very good accounting for the pattern of cost increases in the higher education industry over long sweeps of time. Inflation-adjusted tuition actually fell slightly during the 1970s. This is hard to reconcile with narratives that posit growing inefficiency as a primary cause of the soaring cost of attendance.

The American higher education system has evolved over more than a century to meet a wide variety of social needs, including undergraduate teaching, graduate and professional training, basic research, and public service. It is a system under stress. But the economic and political forces that are tugging at it also affect many other parts of the economy. This is the context that is often missing from the debate, and our work is an attempt to fill in that blank.

Our story about rising cost has no villains, so it lacks a certain sex appeal. We see no simple solutions to the problems of rising college cost that would not reduce quality or ration access. There are indeed problems in American higher education that can be remedied. Our complex financial aid system is a real barrier to increasing the numbers of college-qualified students who benefit from advanced training. And the financing compact between public universities and the states is badly in need of a rewriting. But the first step on the path of wisdom is to ratchet down the overheated rhetoric of crisis and fix what can be fixed.

Robert B. Archibald and David H. Feldman are professors of economics at the College of William and Mary and are the co-authors of **Why Does College Cost So Much?** *(Oxford University Press).*