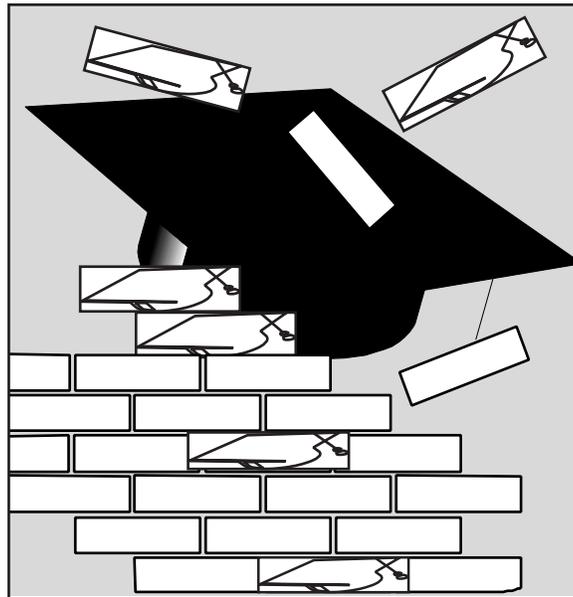


WHY COLLEGE IS TOO CHEAP

J. ISSAC BRANNON

The College Board recently announced that average college tuition and fees went up by less than five percent this year, and while this percentage increase is the lowest in nearly two decades, it is still twice the rate of inflation. This news has been greeted with the familiar articles bemoaning the high cost of college and the difficulty students face financing their education, not that journalists need an excuse to bemoan the issue. Finding an edition of a college newspaper without an article bemoaning the fate of the college student burdened by the “crushing” debt of college is a chore.

In Wisconsin, two different bills seeking to ameliorate this situation have been proposed in recent years. One, sponsored by State Representative Spencer Black, seeks to index the amount of financial aid awarded students to the rate of inflation. Another bill, sponsored by Greg Underheim, seeks to fix at 40% the proportion of the cost of college education actually paid by students. The current budget contains a one year tuition freeze, after an effort to give the individual campuses the right to set their own tuition came under vigorous



opposition as a back-door ploy to increase tuition further.

However, the notion that the cost of a college education is quickly becoming unaffordable is simply unsupported by the data. A public university education, at least in Wisconsin, remains a bargain that is largely subsidized by the taxpayers of the state. Lost in the debate over the “high” cost of college is why college education

should be any business of the state to begin with. Economists of nearly all stripes agree that it is in a society’s best interest to encourage college enrollment to some degree. The real question is how much should college be subsidized, and specifically what students are deserving of government munificence to attend college.

What is the True Cost of College?

Perhaps the biggest mistake that people make when looking at the cost of college education is failing to distinguish between public and private universities. Any parent with a high school senior who has visited a private university is, no doubt, taken aback by the

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tuition, which usually runs well over \$20,000 a year. However, most students do not attend these private schools. To judge the affordability of college by the posted tuition prices of private universities is equivalent to judging the affordability of a car for that same child by looking at sticker prices of Corvettes. Most parents aren't going to buy their children brand new, expensive cars, and whatever car they buy they won't be paying the sticker price, and the child will be none the worse for having a more inexpensive car.

The fact of the matter is that most college students do not attend private schools; at present, around eighty percent of all students attend public universities, which charge a fraction of the cost of private universities with the remainder subsidized by the taxpayers. For instance, in the University of Wisconsin System, tuition this year is a bit over \$3000 a year.¹ Tuition at junior colleges is cheaper still.

Also, most students do not pay their institution's full tuition. Thanks to ample financial aid, only the richest students actually pay the "sticker price" of the university. A survey done by the National Association of College and University Business Officers (which goes by the clunky acronym NACUBO) finds that nearly 80% of all freshman receive some kind of grant that goes toward paying for college. These grants added up to nearly 50% of the average cost of a college education, and NACUBO also reports that this proportion has increased significantly in the 1990s. At public colleges and universities, these subsidies add up to nearly two-thirds of the cost of attending college.² Colleges are perhaps the best practitioners of price discrimination in the entire marketplace. Where else does the cost of the product depend on the income of the purchaser, and in what other industry does the seller actually force the consumer to reveal his income in order to get any discount?

The yearly increases in tuition need to be tempered by the increases in inflation that have invariably accompanied tuition increases. If all wages and prices both increase by 10%, it isn't correct to say that the consumer has been

"hurt" by the price increase; he's no worse off than he was before. To be sure, inflation increases have outstripped tuition increases, but only by a moderate amount. In the University of Wisconsin System, tuition has gone up by roughly 50% in real terms in the last 20 years, which is about a 2% real increase each year. At the same time the cost of room and board has actually *fallen* in real terms, and even this number overestimates the true cost of living on campus, as the quality of life has improved dramatically on most campuses over that same period. The typical college dormitory (or "residence hall" as they are now supposed to be called) over the past twenty years has seen a proliferation of amenities such as fitness centers & workout facilities, access to cable and computer networks in dorm rooms, wider choice in food selection, greater security, and more creature comforts such as air conditioning. Taking the decline in the real price of room and board into account, the 2% annual increase in the cost of college is undoubtedly an overstatement. It is also important to remember that the financial return to a college education increased at the same time, with the gap between college-educated workers and their high school counterparts now at an all time high. David Stager, an economist at the University of Toronto, estimates that the typical rate of return that a student earns from his investment in a college education is about 15 to 20 percent, compounded annually. Such a return beats practically any other investment available in the financial market.

In short, those that decry the ever-spiraling cost of education are clearly overstating their case. College, at least at public universities, remains a bargain for college students.

College as a Public Good

In most states, tuition only covers a small proportion of the costs of giving a student a college education at public universities, with the remainder paid by the state. For Wisconsin, the proportion of college costs covered by tuition is roughly 35%. What does the state get for its investment? Or, to put it another way, why should taxpayers who never attended a

UW school and did not send any of their children to a UW school be forced to subsidize those who do attend college?

Any economist worth his salt would note that the state should interfere in a market by subsidizing a good or service only if there is some external benefit associated with the good or service. For instance, one reason why the federal government provides subsidies to vaccinations is that everyone benefits when their neighbor is inoculated against the measles. So, the government tries to make the cost of such vaccinations as low as possible to induce everyone to take their children to their doctor.

Or to take another example, consider the situation where my next-door neighbor spends \$2,000 landscaping her lawn. While her property value (and enjoyment of her property) undoubtedly goes up, my property value (and enjoyment of my property) goes up as well, without me having to contribute to her landscaping. Because my neighbor has no legal way to get me to contribute money, the amount of landscaping that she does is not what economists would call socially efficient. The last \$1 she spends on landscaping should give her \$1 worth of pleasure, or give her as much pleasure as \$1 spent elsewhere. But that last \$1 she spent on landscaping also gave *me* 20¢ of pleasure as well. Hence, another \$1 spent on landscaping might not be beneficial for *her* but it certainly is beneficial for *society*.

The question is what exactly are these external benefits and are they really *that* big? One benefit is that by increasing the pool of educated workers in the state, it becomes easier to attract companies to Wisconsin. No company hires only skilled college graduates, so from the influx of companies we see higher wages for everyone.

A common final exam question for economics students asks why the wages of barbers and hair stylists has gone up in the last 40 years. At first glance, it seems like their wages shouldn't have gone up after controlling for inflation. The productivity of barbers hasn't changed in the last 40 years; it still takes about a half-hour to cut one head of hair. The training of barbers hasn't changed much either, and there have not been any new barriers to entry erected by the state or the profession. The fact that their wages *have* gone up significantly is due to the overall demand for workers increasing. Since the salaries for lawyers, doctors, and teachers have increased, more people gravitate

towards these professions, and there are less people around to cut hair. Those that remain get higher wages.

States also benefit from subsidizing college by increasing the income of its citizens and thus increasing their future tax contributions to the state. William Johnson, an economist at the University of Virginia, estimates that states in general get a positive return on their education investments, meaning

that \$1 invested in college education generates more than \$1 of future taxes, in present value terms.

Besides higher wages and better jobs, our level of culture benefits from our university system. In many college towns the university is the primary place for plays, concerts, and a wide variety of social events. The influx of students means a small town like Oshkosh or Platteville can attract a whole host of events that simply would not occur without them.

College for Everyone?

The politicians of Wisconsin have made a Faustian bargain with the populace: in order to maintain political support for the state subsi-

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dizing college education, the state subsidizes college education heavily for virtually *everyone*, regardless of a student's wealth or ability. The result is that college professors while away the days teaching remedial classes that should have been covered in high school *or before*.

The University of Wisconsin Oshkosh offers a class called Math 100, which covers "basic concepts about numbers, fundamental operations of arithmetic, algebraic expressions...." A better name for this class would be eighth grade algebra. UWO offers *seventeen* sections of this class in the current academic year, with an average of 25 students in each section. Every Math 100 class taught means there is one less biology, or math, or engineering class. In some respects, the fact that more classes are being taught by part-time and ad-hoc faculty makes perfect sense: since we have classes that aren't really at the college level, why waste our money hiring professors to teach those classes? College isn't for everyone, even though that's the implicit message that our government sends when students without knowledge of high school algebra are admitted into our university system.

There are two possible mistakes that can be made regarding who receives a college education: People who shouldn't get a college education enroll anyway, and people who should get one don't enroll. The first is costly to the state and we'd rather it didn't happen, but it's not a disaster. The student who went to school for a year or two undoubtedly learned a few things of importance, and mere college enrollment does have a positive effect on earnings. And, of course, the student probably had a lot of fun while in college. However, there is a substantial cost to the state of educating these students for a year or two, and it's doubtful that the state receives much in return.

The second situation is extremely costly, not only for that student but also for society. For every 19-year-old who could have been an engineer or manager of a retirement fund or high school geometry teacher and instead takes a job that requires little skill, our society loses. Not everyone can do these jobs well, and

we want to make sure we don't lose people who could do these jobs.

Missed in this calculus is a little-known but important factor called the peer effect. In essence, the idea is that students benefit from being around smart students. One reason we give scholarships to bright high school seniors, who would undoubtedly find it in their best interests to attend college regardless of the costs, is that we want them to attend *our* colleges, so that the rest of the students benefit from their inquisitiveness and intelligence. The peer effect magnifies the cost of mistakenly allowing into college students who have no chance of succeeding.

The question, then, is that if we were to reduce subsidies (and hence enrollment) in our state universities, how many of the legitimate college students would fail to get a college education, and how many of the students who don't really belong in college would get the hint and stay away? More importantly, is there a way to deter those students who are not college material without deterring those who truly belong in college?

I think we can do this, by simply raising tuition significantly at the same time we raise the amount of financial aid made available to deserving students. This way, families with ample funds end up paying closer to the full cost of college, but we can keep the true cost of college lower for students from lower-income families. By insisting on some minimum performance standards for students receiving financial aid we can be sure that the students who truly belong in college remain there, while those less deserving are on their own. For instance, colleges could require a minimum score on the ACT or a minimum GPA in a set of core courses in high school and insist on the maintenance of a minimum GPA in non-remedial courses in order to receive financial aid.

Despite the kvetching of students, University of Wisconsin tuition is significantly lower than the tuition at other public university systems in the Midwest. Such a change would undoubtedly improve the reputation

and quality of our colleges, with the primary beneficiaries being our students in the form of higher incomes after graduation.

What's the Point?

It's probably unrealistic to think that major changes will soon occur in the state's method of funding the university system, but more people are starting to realize that changes need to be made soon. Faculty attrition, student turnover, and remedial classes are all increasing, and none bode well for the university or students. Those who run the university and those who make the decisions about funding the university have to be better about articulating the benefits to the state of having an outstanding university system rather than the mediocre one we have today. In particular, they have to convince taxpayers whose children will not go to a Wisconsin university that

there is still a benefit to the state for having such a system, and they need to convince those who do attend the university that they need to pay more for the privilege.

Notes

1. It is hard to exaggerate the extent to which people obscure the cost of college. For instance, John Lynch, field vice-president and managing principal, American Express Financial Advisors, Madison and Milwaukee, WI, recently advised people on the Larry Miller radio program on WPR that for parents with a young child, college will cost between \$250,000 and \$500,000. His advice: "save a lot of money, and earn a high interest rate."
2. James Heckman of the University of Chicago estimates in *The Public Interest* that roughly eighty percent of the direct cost of a college education is subsidized in some way. The yearly almanac for *The Chronicle of Higher Education* reports that tuition covers less than twenty percent of the total operating costs for both private and public universities.