American Enterprise Institute for Public Policy Research

AEI

No. 12 • December 2009

Education Outlook

Where Does All That Tuition Go?

By Mark Schneider

As any parent with a college-bound child knows, college tuitions are rising much faster than inflation. One way to control costs is to make parents better consumers by giving them better price and outcome information. But the true cost of a college education is hard to calculate because of complex and opaque pricing structures. Today, colleges are spending more on administrators than on faculty or students and using dubious practices to get more revenue from students. Have we reached a tipping point?

As millions of students returned to colleges this year, they faced escalating tuition and other college-related bills that continue to rise far more rapidly than inflation. Indeed, between 2004 and 2007, the Consumer Price Index (CPI) increased by about 10 percent, yet according to data from the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS), the price of postsecondary attendance increased by around 19 percent.[1] The recently released College Board report *Trends in College Pricing 2009* shows that average tuition and fees at public two-year colleges are up over 7 percent from the previous year and at public four-year institutions are up over 6 percent, while tuition and fees at private nonprofit four-year institutions increased 4.4 percent.[2] There also seems to be no upper limit: in a recent tally by *The Chronicle of Higher Education*, fifty-eight private colleges and universities published rates for tuition, fees, room, and board of $50,000 or more this academic year, compared to only five last year. While college costs increased at a brisk clip between July 2008 and July 2009, the CPI *declined* 2.1 percent during the same period.[3]

This recent rise in higher education costs in excess of inflation is not an aberration. According to *Measuring Up*, the 2008 report issued by the National Center for Public Policy and Higher Education, since the early 1980s, growth in college tuition and fees has outstripped changes in the CPI by a factor of four and, according to their calculations, even outstripped the growth in the cost of medical care—the growth of which is recognized as a national crisis.[4] In this *Outlook*, I look at some of the factors behind this rapid growth and at who is benefiting from this extraordinary flow of money from students and their families to institutions of higher education.

Mark Schneider (mark.schneider@aei.org) is a visiting scholar at AEI and a vice president at American Institutes for Research.

Key points in this *Outlook*:

- College tuition costs are rising much faster than inflation, yet graduation rates and other measures of student success remain mediocre.
- Data show that colleges and universities are spending more money on administration than instruction.
- Federal and state governments should tie funding to performance measures to introduce greater accountability.
- We should give parents and students the tools to shop carefully for colleges and universities whose performance justifies their costs.

State Governments versus the Federal Government

"Get all the money you can get. Spend all the money you get." This is how Charles Miller, who headed the Spellings Commission on the Future of Higher Education, describes the way in which higher education institutions in the United States have traditionally conducted business.[5] Miller's formulation is a concise and colorful summary of Howard Bowen's revenue theory of higher education.[6] In this theory, constraining ever-increasing higher education expenditures will come about only by limiting college and university revenues.[7]

We can imagine at least two powerful forces that could limit the growth of revenues (and, hence, expenditures). First, government could limit the flow of public monies to higher education. Second, consumers—students and their families—could vote with their feet by, for example, enrolling in low-cost institutions instead of higher-priced ones, in effect refusing to pay the ever-escalating tuitions and fees charged by many institutions.

Federal higher education policy has been largely focused on financial aid to students without tying such aid to institutional performance. That aid has benefited campuses and the financial industry, but all too often has left students out in the cold.

When we think about how government could limit the flow of revenues, we must keep in mind the limits on the federal government in higher education policy. Some of these limits are built into the federal system of government, in which states have primary responsibility for much of what goes on both in K–12 and higher education. States provide most of the funds to public institutions of higher education (and a few states also provide a share of the funds to private colleges); indeed, state payments to colleges and universities are the major form of taxpayer support for higher education.

States have not often used their authority and powers to limit the flow of revenues to their colleges and universities; nor have they used their authority and power of the purse to hold institutions accountable for producing valued outcomes such as high graduation rates or student learning. Instead, states overwhelmingly fund their colleges and universities based on the number of students enrolled. Such formula-based funding was a major reform in the 1950s, moving higher education funding out of an intensely politically driven budgeting system. Building on this reform, in the 1960s and 1970s states began to add some measure of cost per student to the calculation. Some states went further, experimenting with explicit performance-based funding. These programs, however, have typically involved only a small proportion of total funding, and many of these performance-based reforms have not lived longer than a governor's tenure or a business cycle.

The federal role in higher education funding is more limited. In fact, federal higher education policy has been largely focused on financial aid to students without tying such aid to institutional performance. That aid has benefited campuses and the financial industry, but all too often has left students out in the cold.

The Importance of Consumer Information

While governments could use their power of the purse to help control revenue-fueled growth, another constraint could come from parents and students refusing to pay for the system—for example, by enrolling in less expensive schools rather than more expensive ones. While there is some evidence that students are becoming more interested in low-cost state universities or two-year colleges over four-year ones for basic courses, this trend is likely driven more by the current financial crisis than by any reevaluation of the high cost of postsecondary education.

For consumer choice to gain traction as a way of controlling ever-increasing revenues, students and their families would need to have better price and outcome information; however, there is little transparency in data on higher education pricing, on graduation rates, and on how well graduates do postcollege.

Consider how much students pay for college. Because of extensive discounting through grants and other forms of aid, the net cost of college is often hard to calculate (just as in the market for cars, there can be a large difference between the posted sticker price for a college's tuition and fees and what consumers actually pay).[8] Compounding this complex pricing system, as both the federal and state governments pour more money into colleges, subsidized prices reduce consumer incentives to monitor costs and to push for changes that would reduce costs.[9]

Information on graduation rates is, to be kind, also less than perfect. The only national data source on school-by-school graduation rates is IPEDS, which calculates rates only for full-time beginning students, who constitute less than half of the student population in U.S. colleges and universities. There is even less information available on what happens to students after they graduate and how well they do in the labor market.

Extracting Even More Money from Students

In addition to raising tuition and fees, colleges have other ways of increasing costs. Consider transfer policies. Large numbers of students now attend more than one institution and attempt to transfer credits from previous schools: in 2003–2004, transfer students accounted for around 20 percent of all four-year college enrollments.[10] However, transfer policies, even for seemingly standardized courses such as introductory college mathematics or chemistry, are often complicated and serve to limit or prevent students from moving credits from one school to another. Moreover, students often cannot learn which credits will transfer and apply to which parts of their new school's curriculum until after they enroll.[11]

As both the federal and state governments pour more money into colleges, subsidized prices reduce consumer incentives to monitor costs and to push for changes that would reduce costs.

While confusing transfer policies exist at a wide range of schools, elite schools are working on a new way of getting all the money they can—Advanced Placement (AP) exams. The number of students taking AP courses is rising. In 2008, 1.6 million high school students took 2.7 million AP exams, a 45 percent increase in students from 2004.[12] But some elite schools are now limiting the number of courses for which they will grant credit. A recent Inside Higher Education article focused on Tufts University, which recently joined this club.[13] The article noted that the current cost of an AP test is $86 (many low-income students pay nothing), while a full semester of five courses at Tufts costs about $25,000. The AP route for five courses ($430) is, shall we say, quite a bit less than the Tufts route. Indeed, the article noted that many students use AP credits to graduate early and thereby save money.

Here then is where we are: tuition, fees, and overall student costs of attending college are increasing far faster than inflation and most people's salaries. In turn, students take out more loans, and many work long hours even while enrolled full time. Further, graduation rates at far too many institutions are mediocre at best, in part because colleges and universities are not engaging in the practices that keep students engaged and enrolled.[14] So who is benefiting from rising tuition?

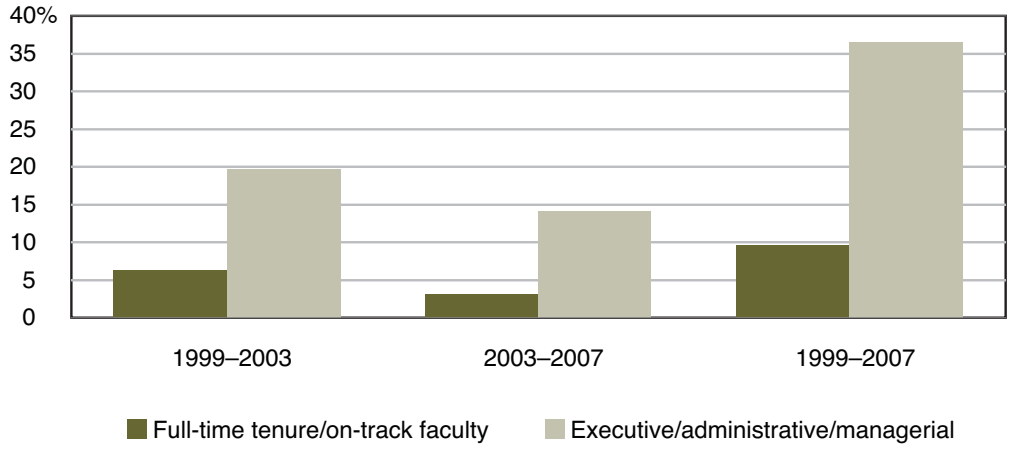
Cui Bono?

Let us look at an interesting pattern of growth in personnel over the last decade. Figure 1 shows that when it comes time to hire, colleges and universities are stocking up more on executives and administrators than on faculty.[15] This helps explain one of the key findings of the Delta Cost Project's recent report *Trends in College Spending*. The Delta Cost Project organizes data on institutional spending and revenues that colleges and universities report to IPEDS into more useful and understandable measures of costs per student and costs per degree or certificate produced.[16] Its recent report found that in recent years, the average college or university has increased its institutional support—which includes general administrative services, executive management, legal and fiscal operations, and public relations—faster than it has increased its instructional expenditures.[17] Figure 2 compares spending between instructional and institutional services from 1998 through 2005 in each of six different types of higher education institutions.[18] Again, like growth in personnel, we see that more money is flowing into administration than instruction.

In short, students seem to be a lower priority than administrators when it comes to allocating revenues.[19] This is part of what Jane V. Wellman, director of the Delta Cost Project, calls "the higher education funding disconnect: spending more, getting less."[20]

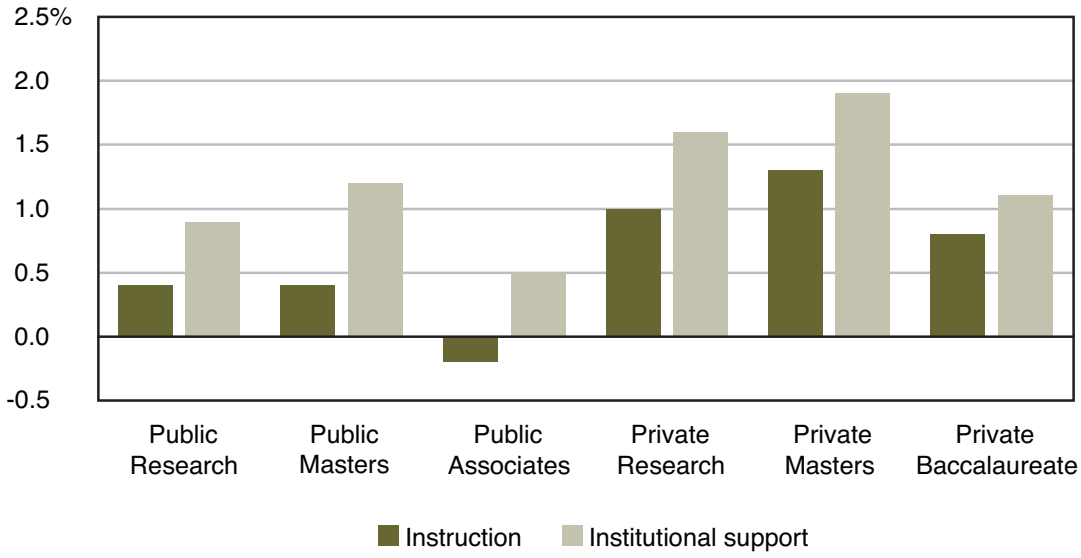
Even more interesting is the pattern of increases in salaries documented in the *Almanac of Higher Education*, a compendium of trend data in higher education issued yearly by *The Chronicle of Higher Education*. Combining salary data from the most recent edition covering the 2008 academic year with earlier data from the 2004 academic year, as reported in the American Association of University Professors's faculty salary survey, we see the tyranny of the alphabet.[21]

FIGURE 1
PERCENT GROWTH IN FULL-TIME FACULTY VERSUS FULL-TIME ADMINISTRATORS, ALL TITLE IV INSTITUTIONS



SOURCE: The Delta Cost Project. Information available at www.deltacostproject.org/data/overview.asp.
NOTE: Title IV institutions are those that receive federal funding to grant students federal aid through grants, scholarships, low-interest loans, and work-study programs.

FIGURE 2
AVERAGE ANNUAL PERCENT CHANGE IN MEDIAN SPENDING PER FULL-TIME ENROLLED STUDENT, 1998–2005

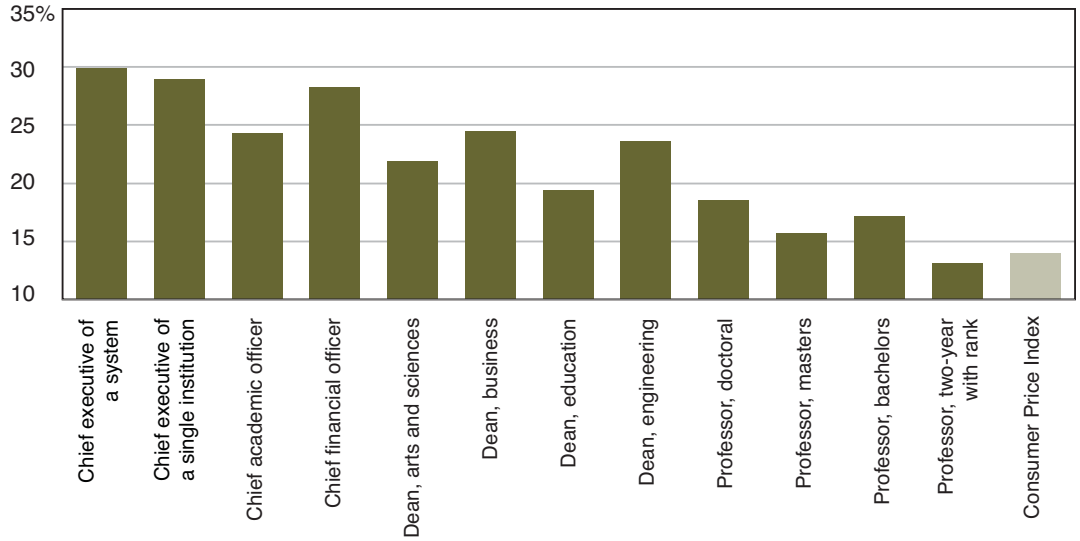


SOURCE: The data are adopted from Jane V. Wellman, "Top-line Findings from Analysis of Revenue and Expenditure Trends" (presentation, ACE-SARA Research Group, Washington, DC, February 29, 2008), available at www.deltacostproject.org/resources/ppt/wellman_dc_2008-02-29.ppt (accessed December 10, 2009).
NOTE: "Public" refers to state-supported colleges and universities. "Private" refers to private, nonprofit institutions.

C Comes before *D*, Which Comes before *F*. Figure 3 shows that if your title leads with a *c*—as in "chief" of almost anything—you win, with average salary increases of close to 30 percent. For more detail, consider data recently reported by *The Chronicle of Higher Education*: presidents at research universities had a median income of $627,750, which was an increase of 15.5 percent over the year before.[22]

Not everyone can be a chief of something; some must settle for being a dean. And just as *d* follows *c* in the

FIGURE 3
PERCENT CHANGE IN SALARIES, 2004–2005 TO 2008–2009



SOURCE: American Association of University Professors, "Economic Status Reports," available at www.aaup.org/AAUP/comm/rep/Z (accessed December 10, 2009).

alphabet, if your title starts with a *d*—as in dean of arts and sciences or dean of education—you lag behind the *c*'s. For the set of deans displayed in figure 3, salary increases were in the 18–25 percent range. And sure enough, if you are an *f*—as in faculty—you fall behind your more alphabetically privileged colleagues, with salary increases around 15 percent.[23] Moving to the end of the alphabet, if you are an *s*—as in student—well, you get to pay for these salary increases that exceed inflation. There is one notable exception: professors in two-year colleges found that their salary increases were lower than the growth in the CPI.

Conclusions

We know that the costs of attending postsecondary institutions are increasing at a rate higher than inflation. And there is evidence that institutions are using a disproportionate share of these revenues for institutional and administrative costs rather than for instructional ones. This (mis)allocation is taking place in an environment in which the federal and state governments continue to pump large amounts of money into higher education without asking institutions to meet performance standards. This is also happening when flawed data systems make it hard even to measure institutional performance and when most of us have a hard time figuring out how much college actually costs.

These trends are affecting how the public regards higher education. A report released in February 2009 by Public Agenda and the National Center for Public Policy and Higher Education highlights the public's loss of faith in colleges and universities. More than half of Americans say that colleges could spend less and still maintain high-quality education. And over half say that higher education today is run like most businesses, with attention to the bottom line trumping the educational mission as a top priority.[24]

AEI economist Herbert Stein once said that "if something cannot go on forever, it will stop." With rising higher education costs, we may have reached the stopping point.

Notes

1. Author's calculations. This is the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS) "tuition and fees variable" calculated from 788 Title IV degree-granting institutions with Carnegie classifications that include baccalaureate/masters college or research universities.

2. Sandy Baum and Jennifer Ma, *Trends in College Pricing 2009* (New York: College Board, 2009), available at www.trends-collegeboard.com/college_pricing (accessed December 10, 2009).

3. This is the so-called sticker price: the listed costs of tuition and fees. Because so many students receive subsidies of one form

or another, the price paid is often lower. How this balances out is subject to dispute, but most analysts see the continued growth in the cost of attending postsecondary institutions as a growing problem. See Tamar Lewin, "College Costs Keep Rising, Report Says," *New York Times*, October 20, 2009.

4. National Center for Public Policy and Higher Education, *Measuring Up 2008: The National Report Card on Higher Education* (San Jose, CA, 2008), available at http://measuringup2008.highereducation.org (accessed December 10, 2009).

5. Charles Miller, personal interview with the author, June 17, 2008.

6. Howard R. Bowen, *The Costs of Higher Education* (San Francisco: Jossey-Bass, 1980).

7. In contrast to Bowen's revenue theory of higher education, William Baumol has argued that the growth in higher education expenditures is a function of the more widespread problem affecting service industries, widely known as the "cost disease." See William J. Baumol and William G. Bowen, *Performing Arts: The Economic Dilemma* (New York: Twentieth Century Fund, 1966); and William F. Massey, "Productivity Issues in Higher Education," in *Resource Issues in Higher Education*, ed. William F. Massey (Ann Arbor: University of Michigan Press, 1996). Since technological innovations are slower and more difficult to implement in service industries, such as higher education, its costs will increase relative to the costs of, for example, manufacturing, in which technological changes can more easily increase productivity. For a recent discussion of these two hypotheses, see, for example, Robert B. Archibald and David H. Feldman, "Explaining Increases in Higher Education Costs" (Working Paper 42, Department of Economics, College of William and Mary, September 2006), available at http://web.wm.edu/economics/wp/cwm_wp42.pdf (accessed December 10, 2009).

8. The Higher Education Opportunity Act of 2008 is making an effort to solve this problem by requiring institutions to help students create a net price indicator, defined as the price of attendance minus grant aid. The National Center for Education Statistics and the Office of Postsecondary Education have recently released a template that higher education institutions can use, or they can create their own calculator.

9. U.S. Department of Education, *A Test of Leadership: Charting the Future of U.S. Higher Education*, report of the commission appointed by Secretary of Education Margaret Spellings, September 2006, 11, available at www.ed.gov/about/bdscomm/list/hiedfuture/reports/final-report.pdf (accessed December 14, 2009).

10. Lutz Berkner and Susan Choy, *Descriptive Summary of 2003–04 Beginning Postsecondary Students: Three Years Later* (Washington, DC: Department of Education), July 2008, available at http://nces.ed.gov/Pubsearch/pubsinfo.asp?pubid=2008174 (accessed December 10, 2009).

11. See Burck Smith, "Price Competition and Course-Level Choice in K–12 Education: Lessons from Higher Ed," prepared for the AEI conference, "More Than Just Schools, Rethinking the Demand for Educational Entrepreneurship," December 7, 2009, available through www.aei.org/event100146.

12. Eddy Ramírez, "Teachers Offer Conflicting Views on AP Program's Rapid Growth," *U.S. News & World Report*'s On Education blog, April 30, 2009, available at www.usnews.com/blogs/on-education/2009/04/30/teachers-offer-conflicting-views-on-ap-programs-rapid-growth.html (accessed December 10, 2009).

13. David Moltz, "Professors and Students Split on AP Credits," Inside Higher Education, February 10, 2009, available at www.insidehighered.com/news/2009/02/10/ap (accessed December 14, 2009). Faculty and student groups are split on this issue. Many faculty argued that the Advanced Placement exam does not certify a high-quality educational experience equal to that offered by Tufts University. Not surprisingly, many students were more sensitive to the cost issue. For example, the article quotes Scott Silverman, Tufts Community Union vice president, as saying, "One of our primary concerns is that this could become a financial burden, changing the way students are forced to pay for education."

14. See, for example, Frederick M. Hess, Mark Schneider, Kevin Carey, and Andrew P. Kelly, *Diplomas and Dropouts: Which Colleges Actually Graduate Their Students (and Which Don't)* (Washington, DC: AEI, June 2009), available at www.aei.org/paper/100019.

15. These are data from IPEDS as reported by the American Federation of Teachers's (AFT) Higher Education Data Center. See AFT, "AFT Higher Education," available at http://highereddata.aft.org/instit/national/instr_staff.cfm (accessed December 10, 2009).

16. These measures allow the evaluation of changes in revenues and expenditures over time and allow comparison of trends and patterns across states or across sectors of the higher education industry. For more information, see the Delta Cost Project's website at www.deltacostproject.org/data/overview.asp.

17. Jane V. Wellman, Donna M. Desrochers, Colleen M. Lenthan, Rita J. Kirshstein, Steve Hurlburt, and Steve Honegger, *Trends in College Spending* (Washington, DC: Delta Project, 2009), available at www.deltacostproject.org/resources/pdf/trends_in_spending-report.pdf (accessed December 10, 2009).

18. The data for figure 2 come from Jane V. Wellman, "Top-line Findings from Analysis of Revenue and Expenditure Trends" (presentation, ACE-SARA Research Group, Washington, DC, February 29, 2008), available at www.deltacostproject.

org/resources/ppt/wellman_dc_2008-02-29.ppt (accessed December 10, 2009).

19. Using Delta Cost Project data, Douglas A. Webber and Ronald G. Ehrenberg explored the effects of different types of expenditures on completion rates, which will engender further research into who benefits from these changing expenditures. See Douglas A. Webber and Ronald G. Ehrenberg, "Do Expenditures Other Than Instructional Expenditures Affect Graduation and Persistence Rates in American Higher Education?" (draft paper, Cornell University, August 1, 2009), available at www.ilr.cornell.edu/cheri/upload/cheri_wp121.pdf (accessed December 10, 2009). See also Ben Eisen, "Cutting Student Services? Think Again," Inside Higher Education, July 29, 2009, available at www.insidehighered.com/news/2009/07/29/gradrate (accessed December 10, 2009).

20. Jane V. Wellman, "The Higher Education Funding Disconnect: Spending More, Getting Less," *Change* (November/December 2008), available at www.changemag.org/Archives/Back%20Issues/November-December%202008/full-funding-disconnect.html (accessed December 10, 2009).

21. American Association of University Professors, "Economic Status Reports," available at www.aaup.org/AAUP/comm/rep/Z (accessed December 10, 2009).

22. Emma L. Carew and Paul Fain, "Paychecks Top More Than $1-Million for 23 Private-College Presidents," *The Chronicle of Higher Education*, November 1, 2009, available by subscription at http://chronicle.com/article/Paychecks-Top-1-Million-fo/48983 (accessed December 10, 2009).

23. The rate of increase for other professorial ranks is virtually the same as for full professor ranks.

24. John Immerwahr, Jean Johnson, Paul Gasberra, Amber Ott, and Jonathan Rochkind, *Squeeze Play 2009: The Public's Views on College Costs Today* (New York: Public Agenda; San Jose, CA: National Center for Public Policy and Higher Education, 2009), available at www.highereducation.org/reports/squeeze_play_09/index.shtml (accessed December 10, 2009).