

A NEW APPROACH FOR CURBING COLLEGE TUITION INFLATION

Beth Akers
Senior Fellow



About the Author



Beth Akers is a senior fellow at the Manhattan Institute, where her work focuses on labor economics and the economics of higher education. Previously, she was a fellow at the Brookings Institution and a staff economist with the Council of Economic Advisers under President George W. Bush.

Akers is the coauthor of *Game of Loans: The Rhetoric and Reality of Student Debt*. Her writing and research have been featured in, among others, the *New York Times*, *USA Today*, *Wall Street Journal*, *Washington Post*, Bloomberg, Quartz, *Newsweek*, and *The Hill*. She has appeared on CNBC, ABC News, Bloomberg TV, and C-SPAN.

Akers received a B.S. in mathematics and economics from SUNY Albany and a Ph.D. in economics from Columbia University.

Contents

Executive Summary	4
Introduction.....	5
Measuring Tuition Inflation	6
Drivers of Tuition Inflation.....	7
Conclusion	13
Endnotes.....	14

Executive Summary

Over the last two decades, prices in higher education have grown more quickly than prices in almost any other sector of the economy. Tuition inflation has been extensively examined. The examinations, however, have focused on a narrow set of explanations, none of which has revealed obvious opportunities for policy interventions that would slow this trend at a reasonable cost. All these are relevant factors, but they approach the issue only from the supply side. These studies neglect to deal with this question: Why has pressure from the market failed to mitigate these effects, as would normally happen in competitive markets for other products and services?

In this report, four other possible demand-side explanations for tuition increases will be discussed:

- ✓ Poor information on the value of different colleges and majors and the “Golden Ticket” fallacy, in which aspiring students seemingly overvalue the return of a college degree

- ✓ The opaque system of pricing that makes comparison-shopping for college difficult and expensive

- ✓ Geographic constraints of aspiring students and the resulting implications on competition

- ✓ Regulation preventing lower-cost alternative business models to enter the marketplace to compete with existing traditional providers

A NEW APPROACH FOR CURBING COLLEGE TUITION INFLATION

Introduction

Over the last two decades, prices in higher education have grown more quickly than prices in almost any other sector of the economy.¹ The relative rise in tuition costs is a problem—not only for students who are paying, or will have to pay, for college but also for policymakers who have made increasing college attendance a central priority.

On average, a college graduate will outearn the typical high school graduate by \$1 million over the course of their careers.² This fact drives our nation's leaders to usher more and more young people into college each year. Even as the cost of college has risen, its economic returns have been positive. But if the trend continues, it would be difficult to imagine that the premium paid to college-educated workers would be enough to offset the increases in tuition such that college would continue to offer a generous return.

Tuition inflation has been extensively examined. The examinations, however, have focused on a narrow set of explanations, none of which has revealed obvious opportunities for policy interventions that would slow this trend at a reasonable cost. For example, many studies have focused on the cost of luxury amenities on college campuses—climbing walls, fitness clubs, lazy rivers, and so on.³ Others have pointed to increasing administrative costs, which have trickled down to students.⁴ And empirical researchers have documented the extent to which declines in state support of higher education have resulted in students paying a bigger share of the cost.⁵

All these are relevant factors, but they approach the issue only from the supply side. These studies neglect to deal with this question: Why has pressure from the market failed to mitigate these effects, as would normally happen in competitive markets for other products and services?

In competitive markets, suppliers compete with one another on quality and price, in an effort to attract consumers. By raising prices, a supplier risks losing customers to lower-priced alternatives. Of course, the higher-education market, which is highly regulated, subsidized, and even partially socialized, differs from this canonical description in countless ways. Nevertheless, price is still set by the institutions themselves, or, in the case of public institutions, by states. However, the downward pressure that consumers can exert on price is dampened by the unusual features of the marketplace for higher education.

One explanation for this is the Bennett Hypothesis, which posits a causal relationship between increases in spending on grant aid—a direct subsidy to students—and prices charged by institutions. The economics here are simple; unfortunately, the evidence is not simple. In a basic economic model, introducing consumer subsidies generally causes an increase in the equilibrium price. The idea is that a consumer's willingness to pay increases by the amount of the subsidy, which allows sellers to ask for a higher price. When sellers of a product or service are aware of this change in consumers' willingness to pay for a product, they can strategically raise the cost to capture some of that subsidy for themselves. This should be particularly true in markets, such as the one for higher education, with high entry barriers that prevent new suppliers from entering the market in response to higher prices.

While many assume that this type of behavior occurs in one form or another, empirical researchers have generated mixed evidence on the extent to which colleges and universities actually set prices in this way.⁶ One reason the empirical evidence deviates from the theoretical model is that the vast majority of students attend public colleges and universities, where prices are often set through a legislative process that involves very different incentives from those for a private firm.

The Bennett Hypothesis has long been discussed as a driver of tuition inflation. And, despite mixed evidence on its explanatory power, it remains popular as a rationale for constraining growth in spending on grant aid. It is not the only explanation for demand-side contributions to tuition growth but merely the most discussed. In this report, four other possible demand-side explanations for tuition increases will be discussed:

- Poor information on the value of different colleges and majors and the “Golden Ticket” fallacy, in which aspiring students seemingly overvalue the return of a college degree
- The “invisible menu,” that is, the opaque system of pricing that makes comparison-shopping for college difficult and expensive
- Oligopolistic competition, resulting from geographic constraints of aspiring students
- Regulation preventing lower-cost alternative business models to enter the marketplace to compete with existing traditional providers

Importantly, these features of the higher-education market can be modified by policy to enable students and aspiring students to put pressure on institutions of higher education—including training programs, colleges, and universities—to offer their services at a price in line with the value that they provide.

Measuring Tuition Inflation

The price tag of a college degree from a private four-year college has grown by a larger dollar amount than the price tag in any other sector. As shown in **Figure 1**, over the past 20 years, the average published price for full-time enrollment at one of these colleges, including tuition and fees, has grown by more than 50% beyond inflation. For the 2019–20 academic year, the average sticker price of tuition and fees at private four-year col-

leges was \$36,880. That’s up \$7,930 over the last 10 years (inflation-adjusted) and \$12,990 over the last 20 years.

Prices have risen similarly at public institutions. At public four-year colleges, the annual sticker price for tuition and fees was \$10,440 for the 2019–20 academic year. That is up \$2,740 from the published price 10 years earlier and \$5,270 from 20 years earlier. That 20-year change amounts to a 100% increase.

Two-year colleges experienced similar trends, with prices increasing by smaller dollar amounts but by large percentages. For the 2019–20 academic year, the cost of tuition and fees at a public two-year college was \$3,730. That’s a comparatively small sum, but it’s much larger than it was 10 years ago (\$2,780) or 20 years ago (\$2,540).

Admittedly, the prices in the paragraphs above overstate the costs facing students. The amount that students and their families have to pay for enrollment, “net price,” is generally much less than the published price (“sticker price”), for two primary reasons. First, students often receive grant aid from federal and state government programs. The Pell grant program allocates up to \$6,345 per year to students enrolled full-time in postsecondary education. Students from the poorest families receive that full amount, and the award size declines as family income and wealth increase.

Second, private colleges and universities sometimes give discounts to students based on their perceived ability to pay. This practice has the benefit of allowing

FIGURE 1.
Published Tuition and Fees, by Sector
(2019 dollars)

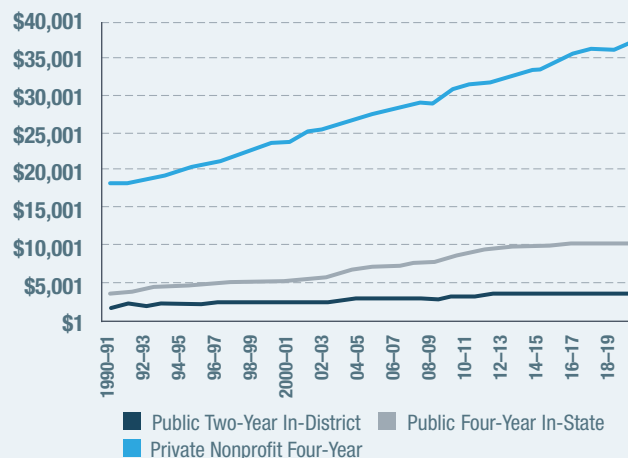
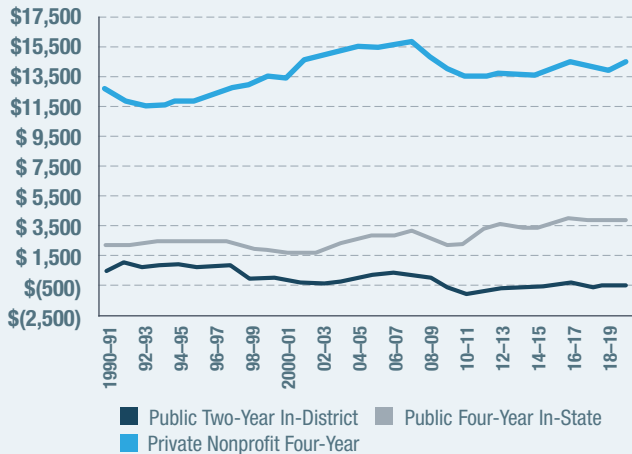


FIGURE 2.

Net Tuition and Fees, by Sectors (2019 dollars)



students to enroll who otherwise would not be able to afford to do so. But it can also be viewed more pessimistically as price discrimination, which is generally perceived as a predatory behavior when exercised by for-profit companies. Essentially, colleges charge students the highest price that they would individually be willing to pay, up to the sticker price, in order to maximize revenue.

Examining changes in net price across sectors reveals a somewhat different picture from the one of published prices. For four-year private nonprofit colleges, the increases in sticker prices have been largely offset by increases in grant and scholarship aid. While the sticker price for tuition and fees at these colleges has risen to almost \$37,000 per year, the net price—the average price actually being paid by the students—is still less than half that amount, at \$14,380. That’s up from a decade earlier but only 3% above inflation.

The average net price, shown in **Figure 2**, at two-year public colleges has remained largely unchanged over the last two decades, with typical students today paying nothing for tuition and fees and having some of their government grant aid (\$430 in 2019–20) returned to them to help cover living expenses while enrolled.

In contrast, students at public four-year colleges have seen their net costs go up significantly because of increases in tuition that were not offset to the same extent by aid and scholarships. The average annual net cost at a four-year public college has grown by almost 81% beyond inflation over the past decade, to \$3,870.

One last wrinkle is helpful to understand before we investigate the drivers of tuition inflation. The prices

often cited for higher education can also include living expenses, either to cover on-campus housing and food or to allow a student to pay for off-campus housing and groceries. These costs are often included in the discussed price, even for students who don’t live on campus, because students can borrow from the federal loan program to cover these expenses. This adds an additional element to the trend of inflation in higher education.

As shown in **Figure 3**, at public two-year colleges, the cost of living (i.e., room and board) has increased but not by much above the rate of inflation. In contrast, at both public and private four-year colleges, it has grown by 18% and 17%, respectively, above inflation. The cause of this disparity is difficult to pinpoint but may reflect the “arms race” at residential colleges, which has prompted many to build bigger and better living quarters and amenities for students living on campus.

While the trends in net prices aren’t quite as severe as the trend implied by published prices, the pattern is nonetheless concerning. As the cost of college increases, the returns for investment in education will decline unless there are corresponding increases in the wage premium paid to college-educated workers. Since higher education serves as a primary mechanism for social mobility in our economy, it is important to rein in unnecessary tuition inflation. The remainder of this report will examine features of the marketplace for higher education that may be contributing to this trend, and it will identify appropriate policy interventions that could work to dampen inflation.

Drivers of Tuition Inflation

1. Poor Information on Value and the “Golden Ticket” Fallacy

In the market for higher education, buyers’ willingness to pay will depend, to a large extent, on their perception of the long-run financial value of education, in the form of higher wages and more consistent employment. While the social benefits of higher education are bountiful, 90% of students report that improved earnings opportunities are the number-one reason they enroll in college.⁷ This means that the demand curve—the relationship between price and desire to enroll—for higher education can be approximated by knowing students’ expectations about the future

FIGURE 3.

Published and Net Prices by Sector, Full-Time Undergraduate Students, 2019-20

	2019-20	10-year change		20-year change	
			(inflation-adjusted)	(inflation-adjusted)	(inflation-adjusted)
Public Two-Year In-District					
Published Tuition and Fees	\$3,730	\$670	22%	\$1,190	47%
Room and Board	\$8,890	\$480	6%	\$1,230	16%
Published Tuition and Fees and Room and Board (TFRB)	\$12,720	\$1,150	10%	\$2,420	23%
Net Tuition and Fees	\$(430)	\$200	na	\$(430)	na
Net TFRB	\$8,560	\$680	9%	\$800	10%
Total Grant Aid and Tax Benefits	\$4,160	\$470	13%	\$1,620	64%
Public Four-Year In-State					
Published Tuition and Fees	\$10,440	\$2,020	24%	\$5,270	102%
Room and Board	\$11,510	\$1,770	18%	\$4,240	58%
Published TFRB	\$21,950	\$3,790	21%	\$9,510	76%
Net Tuition and Fees	\$3,870	\$1,730	81%	\$2,070	115%
Net TFRB	\$15,380	\$3,500	29%	\$6,310	70%
Total Grant Aid and Tax Benefits	\$6,570	\$290	5%	\$3,200	95%
Private Nonprofit Four-Year					
Published Tuition and Fees	\$36,880	\$6,210	20%	\$12,990	54%
Room and Board	\$12,990	\$1,880	17%	\$3,820	42%
Published TFRB	\$49,870	\$8,090	19%	\$16,810	51%
Net Tuition and Fees	\$14,380	\$420	3%	\$950	7%
Net TFRB	\$27,370	\$2,300	9%	\$4,770	21%
Total Grant Aid and Tax Benefits	\$22,500	\$5,790	35%	\$12,040	115%

Notes: Estimates of net price exclude military/veterans' aid, which awards relatively large amounts to a small number of students. Because information on grant aid and education tax benefits for 2019-20 is not yet available, the net price for 2019-20 is estimated based on 2018-19 financial aid data. Room and board expenses for the public two-year sector are estimated based on housing and food costs for commuter students.

Sources: College Board, Annual Survey of Colleges; Trends in Student Aid 2019; NCES, IPEDS Fall

return. Prospective students' expectations about how much more they will earn with a degree should almost entirely determine how much they are willing to pay for school.

In the past, estimating the value of a particular college degree in terms of future earnings opportunities was a futile exercise. Students were forced to shop and decide how much to pay for college, with little more than anecdotes to inform their decision. A cost-benefit-style analysis was not possible because aspiring students had no access to reliable information on how students who attended before them fared in the labor market after graduation.

That dearth of information for aspiring students was partially rectified in 2015, when the Obama administration implemented a policy requiring every accredited college in the country to publicly report information on the earnings of graduates, which was published on a single government website: the College Scorecard.

At first, the only information available was the average earnings across an entire institution. But four years later, during the Trump administration, it was updated to report median earnings by major within each college, which not only helped students select among colleges but allowed them to make more precise predictions about what they could expect in the labor market after graduation. Despite that upgrade, the data remain

somewhat incomplete. Since the Department of Education is restricted by legislation from creating a comprehensive data set that links earnings records with college enrollment data, the information on the scorecard is based only on the population of students who received federal student aid.

In theory, this policy innovation could have gone a long way in helping aspiring students make decisions regarding how much to pay and where to enroll. Empowered with this information, consumers of higher education could conceivably have put pressure on institutions to charge prices in line with the value that they provide. While it may have done just that for those who used it, it has not been widely utilized by aspiring students.⁸

The underutilization of the College Scorecard came as little surprise. While the website delivers information in a relatively straightforward manner, it would, like many government websites, benefit from improvements in usability.

Making data on graduate earnings available was the first step toward allowing consumers to hold colleges accountable for the outcomes they produce, but it must now be followed by a plan to help aspiring students learn how, when, and why to make use of this information to inform their enrollment decisions.

Historically, the emphasis from political leaders has been on promoting college enrollment and degree completion rather than encouraging savvy shopping for colleges and degree programs. For example, President Obama famously declared during his 2011 State of the Union address that he had set a goal for America to “once again have the highest proportion of college graduates in the world.”⁹ His rhetoric suggested that college degrees, regardless of the field of study, were the only way to keep our economy competitive in the international marketplace. The message seemed to imply that college degrees functioned like “golden tickets” (à la *Charlie and the Chocolate Factory*) granting recipients financial prosperity and putting them on the pathway to the American Dream.

While college pays large dividends on average, many students enroll in college only to be left worse-off financially than when they started. College is an investment—and, as with any other investment, making an ill-informed decision on where or how to invest can lead to trouble. This message of college as the “golden ticket” encouraged more Americans to pursue education after high school but did not call attention to the need for aspiring students to critically examine the opportunities they were considering. If students believe

that most any college degree will do, they may be less sensitive to rising tuition than they would be if they more sharply discerned the value of schools and degree programs.

The introduction of the College Scorecard was a critical first step, but we need further efforts to help aspiring students more effectively scrutinize the marketplace for higher education when they decide how much to spend and where to enroll. A number of reforms would encourage these efforts:

- Congress should repeal the ban on a unit-record data system at the Department of Education, so that the College Scorecard could include data from the entire population of students rather than only those who received financial aid. This would improve the data quality, making it easier for students to rely on the accuracy of this information as they search for a college to suit their needs.
- The Department of Education should continue to refine the College Scorecard website so that it provides a user-friendly experience for aspiring students seeking information about potential colleges. Consideration should be given to publishing additional tools to help users place the information in context. For example, salary data should be shown relative to statistics on earnings of less educated workers. Additionally, information on regional variation in cost of living would help students appreciate the trade-offs among various colleges, majors, and careers after graduation.
- Political and civic leaders should not only encourage students to enroll in college but should encourage them to make evidence-based decisions regarding how much to pay and where to enroll. They should also encourage journalists and other third-party analysts to use data from the College Scorecard to create their own tools for helping aspiring students shop for college (e.g., *Money* magazine’s value-based rankings).

2. The Invisible Menu

Under normal circumstances, consumers have an awareness of the menu of goods and their associated prices. For example, a quick search for “laptop computer” on Google will show nearly all the options available to purchase and their prices. That transparency in pricing means that we can comparison-shop to ensure that we’re getting the best deal. Transparency also forces sellers to compete with one another for our business. Unfortunately, college pricing doesn’t work

that way.

Published prices for tuition and fees are often far different from the prices that students pay after taking into account the discounts provided by the college and grant aid given by the federal and state departments of education. Aspiring students do not know what their price to attend a particular college will be until they have applied and been accepted. After a student receives an acceptance from a college, a financial-aid award letter, indicating the discounts and grant aid available, will typically arrive in the following weeks.

The result of this pricing process is that aspiring students must make decisions about if and where to enroll based on a limited set of information about the options available to them. This lack of transparency limits the extent to which competition among institutions can put downward pressure on prices.

The lack of transparency in grant aid would be easy to remedy. The federal government should replace its overly complex system for allocating grant aid. For example, we could replace the Pell grant award “formula,” which incorporates extensive information about a student’s level of income and wealth, with a simple look-up table based on adjusted gross income from the previous tax year. This method, like any other, has the potential to underestimate need. For example, adjusted gross income from a previous year would be a poor indicator of need if the student’s family experienced a layoff or other major financial event in recent months. For this reason, it would be important to retain the appeals process that is already in place to allow students to receive special consideration.

Allowing students to anticipate their eligibility for federal grant aid before they apply means that they’ll have a better idea of how much they’ll pay. This will help them to make price-conscious decisions about if and where to enroll.

Unfortunately, the lack of transparency in college pricing, or discounting, is a more challenging problem to solve because it would require that colleges make a change in the way they currently do business.

In 2011, the Obama administration took a first pass at solving this problem by introducing a regulation that required colleges to publish a tool on their websites called a “net price calculator.” Aspiring students could input information about their financial circumstances, and the calculator would provide an estimate of how much a student would be charged in tuition and fees if accepted.¹⁰ These estimates, however, are not binding offers and often differ substantially from the price

that is later charged. One study showed that students’ actual offers differed by thousands of dollars from the ones indicated on the calculators.¹¹ Perhaps more important, net price calculators have been underutilized, likely because of their complexity.

Limiting the extent to which colleges can use discounting, which is no different from price discrimination, might seem like a natural solution, but doing so would almost mechanically disadvantage less well-off students, who currently have more opportunities than they would otherwise have. Instead, the best approach may be to place additional restrictions on the timing of the application process to ensure that students receive information about their prospective pricing in a manner that allows sufficient time for comparison with other offers. Further standardization of financial-aid award letters could further facilitate this process by making it easier for students to compare their options after they have been received.

Additionally, we should regulate application fees at accredited colleges and universities eligible for federal funding so that students from lower-income families are not financially constrained from applying to—and, if accepted, seeing financial-aid offers from—as many colleges and universities as they would like. These fees currently range from an average of \$50 per application to nearly \$100 at the top of the range. Elite colleges tend to have fees in the upper end of that range.¹²

Recommendations to address the impact of the “invisible menu” on tuition inflation:

- Congress should pass legislation to revise the eligibility rules for the Pell grants so that award amounts can be determined before applying to college, using a simple look-up table.
- Colleges participating in the federal student aid program should be required to notify aspiring students about their eligibility for discounts at an earlier stage in the application process. This could be accomplished by requiring that net price calculators offer binding financial-aid awards, conditional on students providing evidence of their financial circumstances. Alternatively, Congress could impose a notification deadline on colleges to ensure that students are aware of their eligibility for discounts sufficiently early in the academic year to allow time for further comparison-shopping. The exact approach should depend on input from colleges, since logistic challenges could impede proper implementation of either approach. Depending on feedback from participating colleges, a hybrid approach that requires a binding net price calculator or early notification might also be a viable option.



The federal government should regulate college application fees to ensure that they do not impede aspiring students from obtaining sufficient information about the options available to them. Low-income students should be eligible for waivers. Colleges that do not wish to abide by this oversight would have the option of not participating in the federal student aid program.

3. Oligopolistic Competition

When we imagine the marketplace for higher education, we often think only of that particular segment of the market that reflects our own experiences with higher education. We often believe that most students enrolling in college are young people leaving high school and embarking on a four-year residential, sometimes far-from-home, college experience. In reality, the vast majority of beginning college students have a much different experience.

Today's college students are older. Nearly half are over 25 when they first enroll in school. More than one-quarter of college students are parents. Almost half (46%) of college students don't live on campus. The majori-

ty (62%) hold jobs while they're enrolled, with many working full-time (26%). With the added challenge of managing work and parenthood, it's no surprise that 38% of students are enrolled only part-time.¹³

When we realize the manner in which Americans are using higher education, it's easy to see that the marketplace for higher education is not quite as expansive as we might have imagined. While more than 6,000¹⁴ colleges and universities in the country have accreditation and eligibility for federal student aid programs, the set of choices for most students is far more constrained. For most, markets for higher education are exceedingly local. Most students don't pick up and move their lives across the country to enroll in college. In 2016, 40% of first-time, full-time college students were enrolled at a college within 50 miles of their home.¹⁵ Presumably, part-time students will generally stay even closer to home (though this figure is not as easily measured because of data constraints).

A geographically constrained marketplace means that many potential students will choose between a limited number of options within a reasonable commuting distance from home. A small number will actually have

no options for enrolling in college without relocation away from home. A recent report estimated that 3.5% of the U.S. adult population live an “education desert,” meaning that there is no public college or university within 50 miles.¹⁶

In practice, this can lead to what is known as oligopolistic competition, in which a market is dominated by a small number of firms—or, in this case, colleges. Theory predicts that this constraint on competition could result in higher prices than would prevail in a more competitive market, though empirical evidence on this point is lacking.

Of course, more than half the prices in the higher-education marketplace are set by policy rather than by profit- or revenue-maximizing executives, meaning that depressed competition might not result in increased prices. But it seems likely that the lower levels of competition for students created by geographic constraints on enrollment have driven some level of inflation, at least in the private sector, where prices are more likely to be set strategically. Even if prices are not set strategically, geographic isolation might alleviate pressure on institutions to continually improve quality, which is equally, or even more, problematic for students.

In theory, the advent of online education should have upset this dynamic by introducing a dramatic increase in the number of options available to potential students constrained by geography. But in practice, online education has largely failed to thrive as an industry and has left educationally “deserted” students with only a small number of options, without much additional competition from online offerings. Only 14% of students currently enrolled in college are attending college completely online.¹⁷

Public colleges and universities have lagged in developing online programs that would expand access to higher education and provide options for students from every region of the country.¹⁸ Expanding online offerings would not only give current students more flexibility; it would open the possibility for enrollment to a new population of potential students. Beyond that, it would create an incentive for colleges and programs of study in distinct markets to compete on both price and quality.

In an ideal world, a previously isolated student in Montana seeking to begin nursing school would be able to shop among programs offered in state colleges and universities across the country, as well as those offered by private institutions, such as Western Governors University (currently the only nonprofit, accredited college operating entirely online). While it’s difficult

to measure or estimate the value of that sort of innovation, it would likely lead to increases in quality or decreases in price, if not both.

Brick-and-mortar colleges across the nation are currently grappling with transitioning to an online platform because of the Covid-19 pandemic. The rapid shift to online-only education has likely not been beneficial for many students; but perhaps a silver lining will emerge in the forced adoption of online education technology and offerings that will ultimately result in lower-cost or higher-quality opportunities.

State legislatures should direct public colleges and universities to develop more online courses and programs for aspiring students. In doing so, states should build online education programs under the state system brand and avoid having competing programs across different campuses. In order for these programs to succeed, resources will need to be spent on advertising and marketing. Those practices are common in the world of online education and do not undermine educational quality; rather, they support the mission of effectively expanding access to postsecondary education. Additional details on these recommendations can be found in a recent Manhattan Institute report authored by Trace Urdan and Preston Cooper.¹⁹

4. Excessive Regulation

In industries other than higher education, a seller charging “too high” a price will be run out of business by eager entrepreneurs willing to charge a lower price for the same or better service. Consider brick-and-mortar movie-rental shops: Netflix came along and undercut the entire industry by shipping DVD rentals through the mail, using a lower-cost, higher-revenue subscription model. The result was that people could watch more movies at lower cost. One might wonder why an innovative business model hasn’t overturned the higher-education industry in the same way, in order to make higher education available at lower cost.

The answer is that regulation makes it exceedingly difficult for new providers to emerge and flourish. The existing regulations to determine eligibility for federal financial-aid dollars are tailored to the existing business models in the marketplace, and new models of providing education, especially those that deliver education more efficiently (i.e., quickly), are largely excluded.

To gain eligibility for federal financial aid, colleges must participate in a process of accreditation. While standards vary across various accreditors to some extent, education providers offering services that don’t

fit the traditional mold would find it difficult to obtain this stamp of approval. The result is that innovative higher-education providers often have to exist without the benefit of access to federal financial aid, including student loans and grant dollars. Without this advantage, it is very difficult to compete. Colleges and college-like providers occasionally emerge, but the disadvantage of lacking access to federal aid dollars limits the extent to which they can prosper.

The barriers to entry in higher education are artificial, in the sense that they are created by federal intervention, but they are actually a stop-gap solution to a separate problem created by the extensive subsidization of the higher-education marketplace. Because the federal government spends such huge sums on subsidies to higher education through grant and loan programs, veterans' education benefits, tax benefits, and direct payments to colleges and universities, it has an important role in overseeing the quality of the programs to which it is devoting significant taxpayer revenue.

That said, the current system of oversight creates an arbitrarily high barrier to entry. An alternative system of oversight could more effectively incentivize new colleges and universities to emerge and to compete with existing providers. A number of models would likely improve on the status quo; I'll offer one alternative here.

In the current regime, colleges are largely judged based on how they educate students (e.g., curriculum, faculty, manner of instruction) rather than on the outcomes they produce. This means that the system of accountability may not be accurately delivering funds to the colleges that best achieve results for students and taxpayers. Instead, the system of oversight should be based largely on outputs (e.g., first-year earnings, student loan repayment rates). It would essentially be a pay-for-performance model of subsidization. The advantage of this system is that it eliminates the artificially high burden of accreditation and replaces it with a system that rewards precisely those colleges and universities that deliver the return that we are seeking.

In practice, the way to realize this design would be to use deferred compensation to colleges so that they do not receive funds until they have proven job placement, earnings, and financial solvency among their graduates. Schools with a promising business model would be able to borrow against this future stream of income in private financial markets to fund their initial operations. Markets would seek promising new business models and give them a chance to flourish. Private investors would earn a return only if the school delivered

results for its students, and taxpayers would be protected from spending to buoy colleges that look good on paper but fail to deliver results.

Recommendations for increasing competition in higher education by reducing barriers to entry:

- Eliminate the existing accreditation system as the gatekeeper for federal student aid.
- Create an outcomes-based accountability system for higher-education providers so that taxpayer dollars are largely directed to institutions delivering high-quality outcomes (e.g., strong employment opportunities).

Conclusion

Public discourse about higher-education finance has largely moved beyond the problem of tuition inflation to the challenge of rethinking student lending. But reforming student lending or any other aspect of the federal student aid program without addressing tuition inflation is akin to treating the symptoms without addressing the cause. Higher education has long been an important mechanism for social mobility. The U.S. aims to provide economic opportunity for all, regardless of a person's initial circumstances. But if the cost of higher education continues to rise at the current rate, we will see that critical mechanism for social mobility disappear.

So far, efforts to curb tuition inflation have been ineffective, with diagnoses focused on the costs incurred by institutions in educating students. What is needed is a deeper understanding and concern for the market forces, or lack thereof, that are driving—or, at least, allowing—prices for higher education to climb higher than inflation year after year. By introducing policies that make the marketplace for higher education more transparent and competitive, the U.S. can curb tuition inflation, or, at the very least, ensure that college students have access to higher-quality educational programming that offers a significant return on investment.

Endnotes

- ¹ Mark J. Perry, “Chart of the Day . . . or Century?” American Enterprise Institute, Jan. 11, 2019.
- ² Anthony P. Carnevale, Ban Cheah, and Andrew R. Hanson, “The Economic Value of College Majors,” Georgetown University Center on Education and the Workforce, 2015.
- ³ Megan Adams, “What Contributes to Rising College Costs?” EAB, June 20, 2017; Kevin McClure, “Examining the ‘Amenities Arms Race’ in Higher Education: Shifting from Rhetoric to Research,” *College Student Affairs Journal* 37, no. 2 (Fall 2019): 128–42.
- ⁴ Donna M. Desrochers and Rita Kirshstein, “Labor Intensive or Labor Expensive? Changing Staffing and Compensation Patterns in Higher Education,” Delta Cost Project at American Institutes for Research, February 2014; Richard K. Vedder, *Restoring the Promise: Higher Education in America* (Oakland, CA: Independent Institute, 2019).
- ⁵ Douglas A. Webber, “State Divestment and Tuition at Public Institutions,” *Economics of Education Review* 60 (October 2017): 1–4; Michael Mitchell et al., “Unkept Promises: State Cuts to Higher Education Threaten Access and Equity,” Center on Budget and Policy Priorities, Oct. 4, 2018.
- ⁶ Jenna A. Robinson, “The Bennett Hypothesis Turns 30,” James G. Martin Center for Academic Renewal, December 2017.
- ⁷ Rachel Fishman, “2015 College Decision Survey: Deciding to Go to College,” New America Foundation, May 28, 2015.
- ⁸ Michael Hurwitz and Jonathan Smith, “Student Responsiveness to Earnings Data in the College Scorecard,” *Economic Inquiry* 56, no 2.(April 2018): 1220–43
- ⁹ Barack Obama, “Remarks by the President in State of Union Address,” Jan. 25, 2011.
- ¹⁰ “Net Price Calculators: An Overview,” National Association of Independent Colleges and Universities.
- ¹¹ Kaitlin Mulhere, “Families Rely on ‘Net Price Calculators’ to Estimate the Actual Cost of College: A New Study Shows How Misleading They Can Be,” *Money*, Mar. 29, 2017.
- ¹² Ilana Kowarski, “Colleges with the Highest Application Fees,” *U.S. News & World Report*, Dec. 17, 2019.
- ¹³ “Today’s College Students,” Bill & Melinda Gates Foundation.
- ¹⁴ U.S. Department of Education, National Center for Education Statistics, Digest of Education Statistics, 2018 (NCES 2020-009), chap. 2.
- ¹⁵ Ben Myers, “Who Lives in Education Deserts?” *The Chronicle of Higher Education*, July 17, 2018.
- ¹⁶ Ibid.
- ¹⁷ “Today’s College Students,” Bill & Melinda Gates Foundation.
- ¹⁸ Trace Urdan and Preston Cooper, “Taking Education to Students: How Public Universities Have Lagged Online and What They Can Do to Catch Up,” Manhattan Institute for Policy Research, December 2019.
- ¹⁹ Ibid.



