



Cato Handbook for Policymakers

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21. Higher Education Policy

Congress should

- phase out federal student aid;
- phase out federal aid to institutions;
- eliminate all grant programs and research unrelated to national security;
- end pork: require that all federal grants to universities be competitively bid; and
- continue to prohibit the U.S. Department of Education from requiring school “outcome measures.”

In *Universities in the Marketplace*, former Harvard president Derek Bok observes, “Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires.” This chapter explores the harmful effects of federal involvement in higher education, including distortions wrought by feeding colleges’ insatiable financial cravings and efforts to control the ivory tower. When considered in conjunction with the Tenth Amendment dictum that “the powers not delegated to the United States by the Constitution . . . are reserved to the States respectively, or to the people,” the message is clear: the federal government should withdraw from higher education.

Where Are We Now?

Unfortunately, neither the 110th Congress nor the president took the Constitution to heart. In July 2008, Congress reauthorized the Higher Education Act, which greatly increased the federal presence in America’s ivory tower. The reauthorization came on top of two generous student aid measures that Congress enacted earlier in its session. Moreover, in 2005 the Bush administration started formulating a “national strategy” for higher education, seriously threatening the great independence and flexibil-

ity that, despite its problems, have made our higher education system the best in the world.

Since 1965, the federal government has provided an increasingly massive amount of funding for higher education. According to the National Center for Education Statistics, between 1965 and 2007 real federal spending on postsecondary education rose from \$7.5 billion to an estimated \$36.6 billion. Federal expenditures on university-based research also exploded, increasing from \$11.7 billion in 1970 to an estimated \$31.4 billion in 2006.

Given the new laws enacted during the 110th Congress, the federal presence is almost certain to keep growing. The College Cost Reduction and Access Act, signed into law in September 2007, sets a five-year schedule to gradually cut interest rates on federally subsidized loans from 6.8 percent to 3.4 percent, encouraging a lot more student borrowing. The Ensuring Continued Access to Student Loans Act of 2008 increases unsubsidized Stafford loan maximums, eases PLUS loan qualifications, and gives the U.S. Department of Education new authority to fund student lending. Finally, the renewed Higher Education Act increases Pell Grant maximums from \$5,800 to \$8,000 by 2014; authorizes forgiveness of up to \$10,000 in federal loans for anyone working in an area of “national need”; adds numerous reporting requirements for colleges and regulations for private lending; and establishes 64 new programs.

The Adverse Effects of Federal Student Aid

According to *The College Cost Crisis*, a 2003 report from the House Subcommittee on 21st Century Competitiveness: “America’s higher education system is in crisis. Decades of uncontrolled cost increases are pushing the dream of a college degree further out of reach for needy students.” Ironically, student aid is a major force behind the crisis.

It’s a simple matter of supply and demand. On the demand side, more and more Americans have sought a college education, pushing prices higher. Ordinarily, the upward pressure would have been restrained by consumers’ willingness and ability to pay, but, as economist Richard Vedder explains in *Going Broke by Degree: Why College Costs Too Much*, because third parties like the federal government absorb tuition increases, budget constraints have been diminished. “The shift to the right of the demand curve for students—and the resulting higher tuition,” Vedder writes, “[have] been aided and abetted by a large and proliferating number of government assistance programs.”

Explaining the supply side is the so-called Bennett hypothesis, put forth in 1987 by the then Secretary of Education William Bennett, who argued that “increases in financial aid . . . have enabled colleges and universities blithely to raise tuitions, confident that Federal loan subsidies would help cushion the increase.”

Figures 21.1 through 21.3 bear out this aid effect, showing how student aid (primarily coming through the federal government) diminishes customers’ sensitivity to price increases. The tallest bars in each figure are the

Figure 21.1
Private, Four-Year Institution Tuition, Fees, and Room and Board before and after Aid (2006 Dollars)

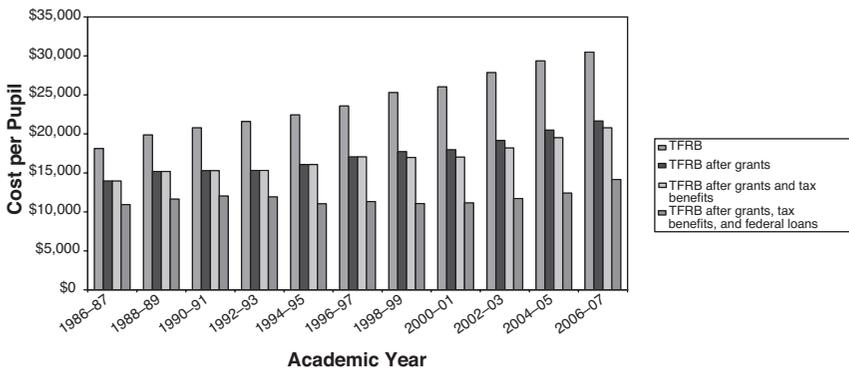


Figure 21.2
Public, Four-Year Institution Tuition, Fees, and Room and Board before and after Aid (2006 Dollars)

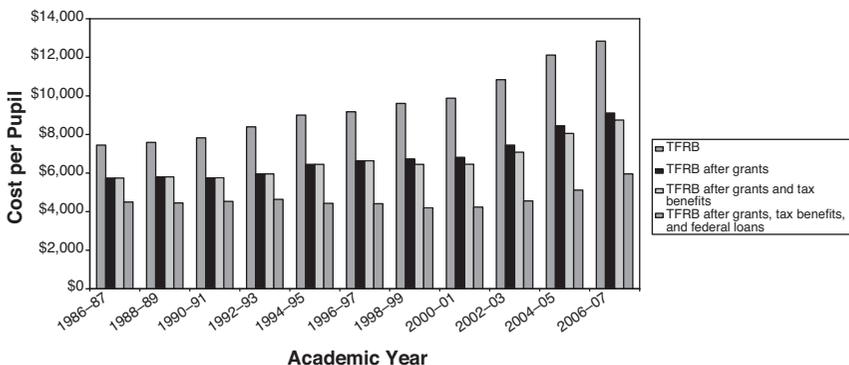
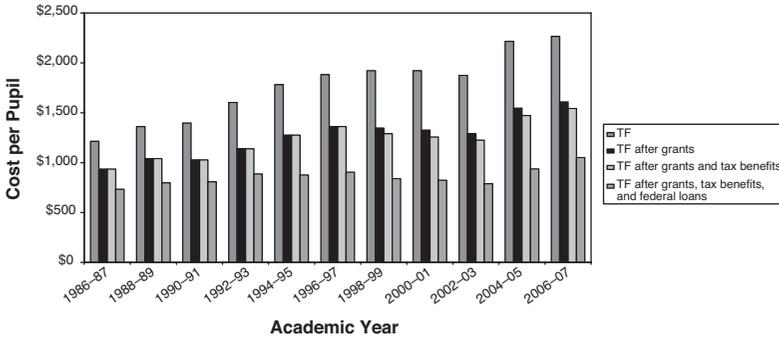


Figure 21.3
Public, Two-Year Institution Tuition and Fees before and after Aid
(2006 Dollars)



SOURCES: U.S. Department of Education, National Center for Education Statistics, *Digest of Education Statistics 2007*, Table 210; College Board, *Trends in College Pricing 2004*, Tables 4a and 4b; College Board, *Trends in College Pricing 2007*, Tables 3b, 4a, and 4b; and College Board, *Trends in Student Aid 2007*, Table 7 (available upon request from the College Board).

NOTE: TF = tuition and fees; TFRB = tuition, fees, room and board. Aid per student was estimated by calculating enrollment-weighted average TFRB and adjusting average grant, tax benefit, and loan aid proportionate to differing TFRB costs by school type. Numbers also adjusted to estimate aid and costs for undergraduate students only.

published costs of tuition, fees, and room and board (TFRB). (Note that two-year public schools do not usually have room and board charges so only their tuition and fees are shown. Two-year private schools, with relatively tiny enrollments and no available cost data, are omitted.) The middle two bars are the costs after subtracting grants and tax benefits, aid that makes students largely insensitive to the costs it covers because it needn't be paid back. The final bars show TFRB after subtracting federal loans as well as grants and tax benefits. The loans do not completely desensitize students to the costs they cover, but with low interest rates and generous terms, they soften the blow.

These tables show that increasing aid doesn't supply all the fuel for the college-cost skyrocket, but it does furnish a lot. For instance, had students had to pay the full "sticker price" increase at four-year private schools (Figure 21.1), the average cost in real dollars would have risen from \$18,122 in 1986-87 to \$30,497 in 2006-07, a 68 percent increase. After accounting for average grant and tax-based aid, however, the increase was only 49 percent, and the price to the consumer went from only \$13,966 to \$20,781. After adding loans, the cost grew from \$10,943 to \$14,158, just a 29 percent increase.

Even after hugely inflating prices, federal aid has probably helped some students attend college, with enrollment increasing about 48 percent between 1986 and 2006. But it's brought other distortions in addition to inflation. Part of the enrollment increase, for instance, came from increasingly large percentages of students requiring remedial work, students who might not have tried college—which they finish at significantly lower rates than nonremediated students—if they'd had to pay the costs themselves. College also seems to be getting easier as colleges scramble for money: the American Academy of Arts and Sciences reports that from the mid-1960s to the mid-1990s, college grade point averages grew steadily whereas Scholastic Aptitude Test scores declined.

That might be why outcomes have not improved. According to the Population Studies Center at the University of Michigan, within eight years of graduating, 51.1 percent of students in the high school class of 1972 had finished two- or four-year college degrees. In contrast, only 45.3 percent of 1992's high school class had done the same. In addition, while college attendance is up, overall adult literacy has barely budged. A federal assessment found that in 2003 only 13 percent of Americans 16 years old or older were "proficient" in reading prose, understanding written directions, or performing quantitative tasks. This dismal score was down from 1992, when 15 percent of Americans were proficient in prose and document literacy. To a significant extent, it seems a college degree may just be replacing a high school diploma as a sign of minimum competence.

It's difficult to say, of course, exactly how many students would have attended college without federal aid, but it's fairly clear that the poor—those people federal aid is supposed to most help—are hurt worst by aid-driven inflation. According to the National Center for Education Statistics, most students intending to pursue postsecondary education and their parents overestimate the cost of college, but lower-income parents and students overestimate the most, disproportionately dissuading them from pursuing higher education. Moreover, aid has been increasingly skewed toward middle- and even upper-income students. Tax credits and deductions are available only to families with sufficient income to pay taxes, and institutions have been spending more of their own dollars on "merit" aid for high-performing, disproportionately wealthier, students.

With all this in mind, phasing out federal aid probably wouldn't result in diminished accessibility for truly college-ready students. For one thing, even now philanthropists support many promising, low-income college kids; they would have much greater incentive to do so were the federal

government not in the aid business. Even better, although it is distorted, the financial value of a college education is still very real. That means private lenders would have a strong incentive to work with qualified, low-income students; both borrower and lender would profit. Most important, ending federal aid would drive prices down. Students and parents would demand only those things for which they themselves were willing to pay, and schools would have to get maximum value out of everything from increasingly underused buildings to bloated staffs to make themselves affordable.

Of course, no school official has ever confessed to setting tuition to capture aid, or to becoming wasteful from an abundance of cash. Several college presidents and administrators have, however, admitted that universities grab every dime they can get. Bok, recall, likened universities' greed to that of exiled royalty and compulsive gamblers. In *Honoring the Trust: Quality and Cost Containment in Higher Education*, former Stanford University Vice President William Massy writes that "universities press their pricing to the limits that markets, regulators, and public opinion will allow." Finally, in a 2006 *New York Times* article, former Emory University President William M. Chace offered "the honest talk" he wanted to give incoming freshmen, explaining that "like the auto industry, we have a sticker price and the price people really pay," and that college "could be cheaper, but . . . you and your parents have made it clear that you want the best . . . more spacious and comfortable student residences . . . gyms with professional exercise equipment, better food of all kinds," and so on.

The Trouble with Institutional Aid and Research Grants

Although the federal government provides about 65 percent of all student aid, states provide the most aid to institutions. But that doesn't make federal institutional aid irrelevant.

Generally, federal aid is given to special classes of schools. The Department of Education *Fiscal Year 2009 Budget Summary* reports that in 2008 Congress appropriated nearly \$800 million in institutional aid, primarily for historically black colleges and universities (HBCUs) and other minority institutions. In addition to this amount, Howard University, an HBCU in Washington, received a specific appropriation of \$233 million, and Gallaudet University, a school for deaf students also in Washington, received over \$113 million.

Although this aid is limited, it still presents problems, the most fundamental being that it takes money from taxpayers and gives it to schools

avored by politicians. Moreover, it gives receiving schools unfair advantages over competing institutions. For instance, in 2008 Howard University received almost 60 percent of what all the other HBCUs in the country got combined—\$395 million—giving it a clear financial leg up on its HBCU peers.

A much larger problem is federal research funding, which the National Center for Education Statistics estimates totaled \$31.4 billion in 2006. Why so much federal investment in research? It is partially for national defense; universities do a great deal of work for the Pentagon and defense-related projects. The other major thrust is “basic” research that promises little or no immediate profit and which, its supporters argue, would not get done without federal financing.

Vedder finds that much of this supposedly basic research is neither necessary nor likely to be undertaken only with federal dollars. He points out that researchers often seek grants after their research is nearly complete, frequently use grant money just to refine research, and undertake projects that industry is willing to do.

In addition to this waste, universities’ growing emphasis on research has come at the expense of teaching. “For many institutions, the balance between research and education has tilted too far toward research,” declares Massy. “Faculty time represents the university’s most important asset . . . [but] there are only so many hours in a day, and even the most highly motivated professors have finite amounts of energy.”

Pork

One final source of federal money is described by the *Chronicle of Higher Education* as “directed, noncompetitive appropriations,” aka pork. As the *Chronicle* reported in March 2008, these projects are costing taxpayers more money every year, from \$528 million in 1998 to at least \$2.25 billion in 2008. And what has the barrel produced? According to *Lobbying for Higher Education* by Vanderbilt University professor Constance Ewing Cook, over the years it has included such gems as \$8 million to build a planetarium for Delta College in Michigan, a community college that offers no science majors, and \$21 million for West Virginia’s Wheeling Jesuit College, a bounty almost twice the size of the school’s annual budget. In 2008, earmarks included \$140,502 “to maintain healthful interscholastic youth-sports programs” at the University of Maine; \$98,000 to build a “Student Wellness and Recreation Center” at Heidelberg College in Ohio; and \$1,915,934 for the Charles B. Rangel

Center for Public Service at the City University of New York, earmarked by Rep. Charles B. Rangel (D-NY).

Still a Pretty Free Market

Even with the significant distortions in American higher education, ours is widely considered the best postsecondary system in the world. Driven by consumer freedom and competition among autonomous institutions, it has an unmatched vibrancy. That's a major reason why in 2007, according to the Organisation for Economic Co-operation and Development, the United States was "by far the most popular destination for international students."

In light of this market-driven strength, arguably the biggest recent threat to America's ivory tower hasn't come directly from rampant price inflation, but from federal efforts to impose new controls on colleges and universities largely justified on the grounds that Washington makes a huge "investment" in higher education. Employing this reasoning, in September 2005, Secretary of Education Margaret Spellings announced the creation of a commission tasked with formulating a "comprehensive national strategy" for American higher education. On the heels of the No Child Left Behind Act—which imposed unprecedented federal control on elementary and secondary education—the commission's charge signaled that the Bush administration was looking to force "standards and accountability" on academia.

The commission's final report stopped short of advocating outright federal imposition of standards and tests, but it did call for the creation of "a national strategy for lifelong learning" and a federal database populated with information on every college student in the country. Worse, after the report's release Spellings tried to impose outcome-measurement requirements on schools through regulation of accreditors, bodies whose stamp of approval is needed for colleges and students to receive federal aid. To be recognized by the federal government, accreditors would need to require schools to have explicit outcome measures, a requirement likely to translate into standardized tests for incoming and outgoing students.

Congress's response to these efforts was on target. In May 2007, Sen. Lamar Alexander (R-TN) threatened to introduce legislation barring the secretary from imposing such regulations. A House subcommittee promptly attached an amendment to a 2008 spending bill prohibiting the Department of Education from promulgating new accreditation rules. Finally, the reauthorized Higher Education Act forbids the department from

imposing student achievement standards or creating a “unit record” database.

Removal of the Federal Government from Higher Education

James Madison wrote in *Federalist* No. 45: “The powers delegated by the proposed Constitution to the federal government are few and defined. . . . [They] will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce.” Since the Constitution grants the federal government no role in higher education, Washington may only be involved in ways that support legitimate federal concerns. That essentially means maintaining the Senior Reserve Officers’ Training Corps, service academies, and national defense-related research, and otherwise withdrawing from higher education.

Washington cannot, however, withdraw immediately. Abruptly ending federal student aid, for instance, would leave millions of students scrambling for funds and would overwhelm private lenders, schools, and charitable organizations that have made plans based on expected levels of federal involvement. What follows is an overview of a six-year plan that would withdraw the federal government gradually while setting a clear path for devolving Washington from higher education.

- **Immediately:** Prohibit pork barrel spending; only federal grants that are competitively bid can be sent to colleges. Award no new research grants unrelated to national security but let projects under way continue to completion.
- **In four years:** End federal aid to institutions. The four-year time frame offers schools an adequate transition period either to economize or find new sources of revenue because federal aid accounts for only a small part of most institutions’ overall budgets.
- **In six years:** Eliminate all federal student aid programs. Each year between enactment of federal phaseout legislation and the end of the six-year period, the maximum Pell Grant value, incorporating cost-of-living adjustments pegged to inflation, will be reduced in equal increments. Similarly, maximum loan sizes and government subsidy rates will be reduced for all federal loan programs in equal, six-year increments.

Conclusion

The federal presence in higher education is both unconstitutional and harmful. Federal student aid drives up college prices, creates numerous

distortions and inefficiencies, and costs taxpayers ever more. Federal institutional aid, university-based research grants, and academic pork also cost taxpayers billions of dollars each year. Finally, federal efforts to impose “accountability” on the nation’s ivory tower threaten to destroy its greatest strengths: institutional autonomy, consumer freedom, and the powerful competition and innovation they create. Washington must get out of higher education.

Top Five Signs of Too Much Money in Higher Education

1. The Bureau of Labor Statistics reports that college students devote 3.2 hours to education on an average *weekday*, versus 3.9 hours to “leisure and sports.”
2. “Ever needed a beach getaway in the middle of finals week?” asks the University of Missouri in its description of the school’s Tiger Grotto recreation center. The grotto boasts “palm trees and other tropical flora,” a “Lazy River” that “allows you to float along without any effort while you watch ZouTV on the big screen,” and “sauna and steam shacks.”
3. According to *Forbes* magazine, between 1983 and 2007 businesses focused on efficiency and saw their after-inflation energy costs rise 60 percent. Colleges experienced a 124 percent leap.
4. The National Center for Higher Education Management Systems reports that in 2006 the *six-year* graduation rate for bachelor’s students was only 56.4 percent.
5. A 2007 National Center on Addiction and Substance Abuse survey found that almost half of full-time college students binge drink or abuse drugs, while the percentage of students who got drunk at least three times per month rose 26 percent between 1993 and 2001.

Suggested Readings

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—*Prepared by Neal McCluskey*

