

Tuition Rising: Why College Costs so Much

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For at least a century, tuition at selective private colleges and universities has risen annually by two to three percent more than the rate of inflation. It wasn't until the 1980s, though, that tuition growth began to regularly outstrip growth in median family income. During the 1990s, endowments grew enormously as a result of the booming stock market, leading many observers to wonder why tuition needed to be raised at all. Ronald Ehrenberg, Irving M. Ives Professor at Cornell University and director of the Cornell Higher Education Research Institute, discusses a number of forces that put upward pressure on tuition, and recommends several steps institutions can consider to help hold down their costs.

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Cost Pressures on Tuition

Over 30 years ago, William Bowen, now president of the Andrew W. Mellon Foundation, attributed tuition rising faster than the rate of inflation primarily to the nature of the educational process, which did not permit academia to share in the productivity gains that caused earnings growth in the rest of society. Today, several additional forces continue to put upward pressure on tuition.

“Winner-Take-All” Society

The objective of selective academic institutions is to be the best they can in every aspect of their activities. They aggressively seek out all possible resources and put them to use funding things they think will make them better. To look better than their competitors, the institutions wind up in an arms race of spending to improve facilities, faculty, students, research, and instructional technology. Meanwhile, students and their families increasingly want to buy the best: the fraction of our nation's top students, as measured by test scores, who choose to enroll in selective private institutions has increased substantially over time. Research suggests they are wise to do so, because the economic return to attending a selective private institution is large, and increasing.

With long lines of high quality applicants flocking to their doors, top institutions have chosen to maintain and increase quality largely by spending more, not by increasing efficiency, reducing costs, or reallocating funds.

Shared Governance

The shared system of governance between trustees, administrators, and faculty almost guarantees that selective private institutions will be slow to react to cost pressures. Trustees are often successful business people who know how to cut costs and meet budget constraints. But if the president tells them that they need to spend money to maintain the strength of the university in a particular field, or that they need funds to enhance the

living and learning environment to attract students, they are likely to agree.

At public institutions, trustees often do not have control over tuition levels and state appropriations—the political process often makes such decisions. Administrators at the public institutions often can make hard decisions to balance budgets because they can always blame the cuts on state government. In contrast, administrators at private institutions often find that all blame for cutbacks is

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assigned to them. Rather than risk the goodwill of the faculty, whose support they need to effectively govern, they are more likely to agree to raise tuition than take other actions to provide budget relief.

Federal Government Policies

The federal government has contributed to the cost pressure on selective private institutions in at least three ways. First, the Justice Department's breakup of the collective agreement of several elite institutions to target their financial aid to students with the greatest need has led to the increased use of merit aid and more expensive financial aid packages. Second, the value of the maximum Basic Educational Opportunity Grant (BEOG) has not kept pace with inflation. Viewed in 1997 constant dollars, in 1975, the maximum BEOG grant was \$4,000; in



1997, it was \$2,700. Private institutions have had to make up the difference in the form of institutional financial aid, putting more pressure on tuition. Finally, the cost of doing research has skyrocketed in recent years as the government has put pressure on private research universities to reduce their indirect costs rates, and, at the same time, raised its expectations for matching funds in grant applications.

External Actors

While valuable to selective institutions in a number of ways, alumni also tend to discourage institutions from cutting almost anything by threatening to withhold contributions. Academic institutions also face cost pressures from local governments. Obtaining required permits for construction or to develop properties often requires complex negotiations, frequently leading to increased financial payments to local governments to compensate them for the institution's tax-exempt status. Environmentalists and historical preservationists, too, can slow down projects and increase costs much more so than for a for-profit firm: unlike the university, the business firm has the option to pack up and move.

Published Rankings of Institutions

It has been shown that when an institution's ranking in *U.S. News & World Report* improves, the number of applicants increases and the percentage of applicants accepted decreases, while yield and freshmen test scores increase, and the amount of financial aid that must be offered to enroll the class decreases. As a result, institutions have every incentive to improve their ranking. To the extent that the rankings are partially based on how much an institution spends educating each student, pressure to increase such spending

mounts, and unilateral reduction of costs in a number of areas is untenable.

Appointment and Evaluation of Deans

While the president or provost typically makes appointments, searches for deans are often conducted by committees comprised primarily of faculty from the relevant college. Once in office, if a dean is successful at fund raising and external relations, and maintains faculty support, it is difficult for a provost or president to penalize or remove the dean for failing to cooperate in university-wide initiatives. Thus, central administrators have limited power to influence the actions of deans, whose interests most often lie with their own colleges rather than the broader institution.

How Universities Organize Themselves

How institutions are organized for budgetary purposes can have a significant impact on their ability to control costs. Universities use four broad types of resource allocation methodologies, as follows:

- **Central Control.** Nearly all revenue flows directly to the central administration, which covers costs and then allocates some portion of the remaining revenues back to the individual colleges.
- **Tubs.** Each college keeps the revenue it generates, including tuition, and is responsible for all costs that it incurs. Funds are remitted to central administration only to cover allocated shares of central costs.
- **Tubs with a Franchise Fee.** Each college is a tub, but remits more than its share of central costs; this "franchise fee" is allocated back to the colleges at the discretion of the central administration.
- **Activity Driven.** Each college remits to the center a share of its total expenditures; the share differs

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across activities (e.g., teaching, research, etc.). The center covers central costs and allocates excess funds back to the colleges without explicitly having calculated central costs for each unit.

The results of a survey of research and doctorate institutions that I conducted in 1999 indicate that central control is by far the most prevalent form of organization, with 63 percent of the privates and 92 percent of the publics arranged as such. Less than 10 percent of the privates were organized as tubs, and this form was most prevalent in private research I institutions. In practice, however, at nearly half of the institutions under central control, year-to-year percentage changes in the allocation of revenues to colleges did not vary much across colleges. De facto, it appears that the colleges are being treated as tubs at these institutions.

The tub model reduces central administration's control over resources and the actions of deans. It is not the best form to use to improve efficiency and control costs, as what is in the best interests of the individual unit is not necessarily in the best interests of the university. To provide incentives for colleges to raise revenues and hold down costs, as well as contribute to the overall efficiency of the university, variants of the tubs with a franchise fee model or the activity driven models are the preferred alternatives.

Conclusion

Selective private colleges and universities can take several actions to moderate their tuition increases. The resource allocation method an institution uses can have considerable effect on its ability to control costs. In the same vein, deans should be held responsible for the well being of the institution as a whole, not just for their individual college. Trustees and alumni, too, need to be educated to look beyond their special interests. In private institutions, trustees can play a crucial role in backing efforts on the part of presidents and provosts to control costs.

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Further, colleges and universities must assume the mindset of growing by substitution, not by expansion. And finally, institutions must increase cooperation with their competitors. Consortia to share academic and administrative resources both within campus and across institutions promise significant savings in a number of areas. Clearly, tuition increases need not—and, indeed, given the changes sweeping throughout higher education, cannot—march on inexorably for another century.

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