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KEVIN CAREY

The Libertarian's Dilemma

What can we do about the inherent bureaucratic spending spirals?

A couple of weeks ago I was invited to attend a meeting at the Cato Institute to discuss a new paper that explores why higher education is perpetually becoming much more expensive and what do about it. I was happy to attend; while my politics are pretty far from Cato's and I often think they're wrong, they tend to be wrong in interesting ways. And in this case I thought the paper was quite good (more on why below). Its top-line recommendations track closely with something I write about a lot: the need for more transparency and public information about how well colleges and universities serve their students and help them learn.

The problem is that colleges aren't just going to unilaterally release lots of new information on their own. Nor would it help matters much if they did; for data to matter it has to be *standardized* in a way that allows for comparison. That's why companies report one set of quarterly financial results to the SEC, not 50 different sets to each state. Given that higher education is a national market this leads to a similar national solution: The federal government should compel colleges to release much more information about success as a condition of receiving direct or indirect federal aid.

This puts libertarians in somewhat of a box. On the one hand, they tend to be hostile toward the tens of billions of public dollars that flow into colleges every year. The more colleges cost, the greater the claim on the average citizen's hard-earned money and thus reduction in their precious liberty etc., etc.

But the best way to bend down the long-term higher education cost curve and thus reduce government *spending* is to increase government *regulation* in the form of mandatory reporting. So it's a pick your poison situation for the Cato folks — would you rather have Big Brother's hand in your wallet or his eye on your business? You really can't avoid both.

The paper itself, by Robert Martin, is admirably clear and concise, running through a lot of basic economic theory and how it applies to spiralling college costs. Some of it is familiar — the principal / agent problem, Bowen's revenue-to-cost hypothesis, etc. — but it's always nice to see these ideas restated in compelling ways. Good parts include:

> Unlike for-profit firms, the nonprofit organization is accountable to a number of groups. It not only serves its "customers" (in the case of higher education, students) but also its third-party payers (taxpayers or private donors). The nonprofit's customers know about the quality of the product or service, but third-party payers have very little firsthand knowledge about quality. For example, the taxpayers who support a state university are subsidizing the cost of students' education. If the students minimize their efforts, spending more time at football games and parties than in learning, or if educators shirk their responsibilities, giving outdated lectures and not showing up for office hours, they may deliver results well below what taxpayers and donors expect. But taxpayers and donors probably do not know about it.

And:

> In higher education, the principals are taxpayers, students, parents, alumni, and donors, while the agents are faculty, administrators, and board members. As is always the case, the interests of all of these parties are not perfectly aligned.

> One rarely encounters a venal person in higher education. Theft is rare in the ivy halls. Most people working in higher education are dedicated, sincere, and conscientious. But they are also human beings subject to normal human failings.
>
> The particular human failing that leads to the agency problem is the assumption that whatever is in our own interest is also in the institution's interest. Often we are unaware that our interests do not coincide with those of the institution.
>
> I've experienced this lack of awareness myself. As a faculty member at a private liberal-arts college, I welcomed lower teaching loads and smaller classes, telling myself that these benefits gave me time and opportunity to improve my teaching and research. I also welcomed liberal sabbatical policies, more research funds, reduced contact hours, and liberal travel funds for much the same reasons.
>
> Similarly, senior administrators can persuade themselves that lavish offices, extensive building projects, expensive public-relations events, luxury travel, and high compensation are in the institution's interest. Board members may consider expensive social events to be in the institution's interest. The inability to recognize when our personal benefit deviates from the institution's benefit leads
> to excessive costs.

And:

> To understand the incentives that operate in higher education, we need to recognize that the chief objective of the producers may not be education per se, but maximizing the school's reputation. … [This leads] to a bias against reform and a bias toward increasing revenues rather than cutting costs. … Pointing out problems leads to controversies, and controversies damage reputations; hence, reform damages reputations. Even admitting that there are unresolved problems at the institution can damage its reputation. … Suppose you are a faculty member, an administrator, or a board member. Fixing a serious problem will take years, and it will involve considerable controversy. Alternatively, the problem and the controversy can often be temporized by applying more cash to the institution. With more money, for example, more appealing courses can be added without eliminating those with low registrations. Faculty members, administrators, and board members ask themselves: Do I want my tenure to be known for controversy or to be known for an increasing flow of new funds into the institution? The answer is obvious. More funds trump controversies. Thus, board members hire presidents for their fund-raising abilities and pay lip service to cost control.

And:

> Bowen's revenue-to-cost hypothesis is sometimes compared to another traditional explanation for rising higher-education costs, "Baumol's cost disease" (Baumol and Bowen 1967). The two explanations are not competing hypotheses, but Bowen's appears to have more direct relevance to higher education … higher-education finance is a black hole that cannot be filled. The relationship between revenues and subsequent costs has a dynamic feedback effect. Higher education responds to higher costs by raising tuition and fees or initiating fundraising campaigns. But because costs in higher education are capped only by total revenues, there is no incentive to minimize costs. The costs go up in tandem with revenues. The next year, the cycle begins again because the higher costs mean that the new programs must be financed by additional revenues. There is thus a never-ending spiral effect between revenues and cost.

(Brainstorm illustration incorporating a photo by Flickr user Ana Patricia Almeida)

Posted at 04:18:01 PM on July 14, 2009 | All postings by Kevin Carey

Comments

1. I am going to try this again – Kevin – what do you mean by mandatory reporting? What are the indicators of "how well colleges and universities serve their students and help them learn"? What part of a individual's education is their responsibility and what part is the responsibility of the institution?
   While in graduate school I took a number of courses in pedagogy and education policy. The policy courses were frustrating, due to the fact that I thought they were actually about policy development. Silly me – they focused on analysis and theory, but never on how to develop and implement good policy. What is the point of analysis if you don't go to the next step and apply the analysis in developing better policy?
   So – response please! What do you see as valid indicators of "success" and how do you standardize them to fit both large research institutions and small community colleges? What is the mission of higher education? If missions vary between larger and smaller institutions, would