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KEVIN CAREY

The Libertarian's Dilemma, Cont'd

Last week I wrote that the problem of runaway college spending presents libertarians with something of a dilemma, because, "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 [of information about institutional performance]."

Unsurprisingly, Neal McCluskey of the libertarian Cato Institute disagrees. I think he's unpersuasive, but before I explain why it's worth reviewing the central argument of the paper that prompted this discussion, *The Revenue-to-Cost Spiral,* by Robert Martin, published by the conservative John William Pope Center for higher education policy.

Martin begins with the principal / agent problem, an issue that's endemic in large modern organizations. Essentially, the problem arise when the interests of people who own or otherwise have a stake in an organization (the principals) are misaligned with the people who actually run the organization (the agents).

For example, a few years ago the shareholders (i.e. principals) of insurance giant A.I.G. employed a guy (i.e. an agent) named Joseph Cassano who sold billions of dollars of insurance to other large financial companies, essentially protecting them against the risk that their securities backed by subprime mortgages would become worthless in the event of a huge real-estate market collapse. Cassano was paid tens of millions of dollars based on the short-term profits A.I.G. booked, some of which he used to buy a really expensive house in the Knightbridge section of London. Now A.I.G. shareholders have been devastated, but Cassano still owns the house.

In higher education, Martin argues, the principal / agent disconnect is less about risky profit taking and more about *status.* Colleges are inherently status-maximizing institutions, even if the principals — taxpayers, donors, and students — would rather colleges focused on a different set of priorities, like giving every student a high-quality affordable education. As Martin writes,"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 same could be said for giving too much weight to the research mission at the expense of teaching and lots of other things.

How do you get more status, particularly in an industry where reputations are seemingly as ancient and permanent as the stone buildings themselves? You buy it, by purchasing nicer buildings (old-looking stone is a popular choice of materials) and more prominent researchers and students with better SAT scores. Or you just let it accumulate in the endowment, also a major benchmark of prestige. All of this dovetails with Bowen's revenue-to-cost-hypothesis: College spending is capped only by revenues and colleges have every incentive to spend, so they constantly build up fixed costs, raise more money, spend more money, raise more, spend more, and so on.

Martin's solution? More information. To mitigate the principal / agent problem, give the principals more data so they know what's really going on. And the government has to play a role:

> [Reform] has to involve private groups, state and local governments, and the federal government. The most important federal government contribution to reform would be a significant increase in transparency requirements. The information requirements for tax-exempt status should be increased, and the IRS should conduct more and more-intense audits of these institutions. Further, the information provided to the IRS should be in the public domain immediately and available on the institution's Web site or gathered in a single place. The federal government can also increase the quantity and the quality of the information reported to the National Center for Education Statistics (NCES).

That's the libertarian's dilemma in a nutshell — if you think seriously about restraining college costs, it brings you around to more meddling by the IRS, the Department of Education, etc.

McCluskey disagrees. "Wouldn't the best, most direct way to "reduce government spending" obviously be to, well, reduce, or even stop, government spending?" he asks, before advocating for massive public disinvestment in higher education that would cripple thousands of institutions and shut the doors to college for hundreds of thousands of students nationwide. Well, sure! But that's like saying the best way to control long-term health care costs is to spend less money on health care. The relevant question is *how.* (Just to be clear: I'd like to spend *more* public money on higher education, not less, albeit in a way that's substantially more performance-sensitive and directed toward institutions that serve academically and economically at-risk students.)

McCluskey goes on to assert that "Clearly, we don't need government to set standards or inform consumers — markets will do those things themselves." He notes that the market provides consumers with plenty of information about things like hamburgers and cars. Which is true in part while ignoring the government's role in mandating reporting of things like nutritional information and gas mileage.

But the much more obvious example is the way the free market has reacted to the issue at hand, higher education. The free market has given us the *U.S. News & World Report* college rankings, which are *all about status and spending*. Fully 10 percent of each college's score is based on a simple measure of spending per student — the more you spend, the higher you rank. Another 20 percent is based on things that cost money to buy — low class sizes, faculty salaries, etc. — and much of the rest flows from larger reputational and selectivity factors that are directly and indirectly enhanced by spending.

In other words, the free market has created an information environment that *exacerbates* the runaway college-cost problem that McCluskey is supposedly interested in trying to solve.

Meanwhile, George Leef weighs in at *Phi Beta Cons* (at the *National Review*) to endorse the McCluskey spend-less-money-by-spending-less-money solution, assert without evidence that there is "wildly excessive demand for educational credentials" (From who? The private-sector employers who have freely chosen to pay more and more for those credentials over the years?) and essentially disavow the central conclusion of a paper published by the Pope Center, where he (Leef) happens to be the Director of Research.

Jane Shaw, president of the Pope Center, also rejects Martin's proposed solution, saying:

> Wouldn't it be better if schools were motivated to provide the information that their customers — parents and students — want? Different schools could provide information suited to their potential customers. Wouldn't it be more valuable to have information along the lines of Princeton Review's multi-dimensional ratings, which tell you, say, where the party schools are — and let students decide whether those are positive or negative features? I believe that we would have a richer, more satisfying marketplace for education that way than we would with a mandatory website containing statistical "student-learning outcomes" that end up looking rather similar to one another. Rather than asking the federal government to intervene (which it does much too much of already), let's figure out ways to empower the customers.

"Motivated"? What would motivate a college to disclose information that didn't flatter the institution and burnish its status and reputation? Look, I'd be pleased as punch if colleges disclosed the good with the bad out of a sense of civic obligation, but I'm not going to hold my breath. And I'd sort of assumed that the steely-minded conservatives over at the *National Review* would have a similar view of human nature. There's no contradiction between Shaw's hope for multidimensional ratings, which I support, and a transparency agenda. But it's naive to think that colleges are going to get there on their own, which leaves one option — the government, like it or not. Posted at 04:55:33 PM on July 20, 2009 | All postings by Kevin Carey

Comments

1. Public institutions, at least, have print outs of budgets and financial statements that are public documents. Not unlike the budgets of cities, the budgets of public coleges can be requested by the public. What is to prevent an entrepreneur from requesting/reviewing the bugets /statements, compiling public-friendly reports (interpretation is the key to understanding budgets for the average person)and selling them on Amazon? The same goes for police reports. Under the FOIA, ordinary citizens can request to see police statistics (how many times are the cops called to the frat houses. etc..) Constructing a matrix of public institutions shouldn't be that difficult. There's a lot of reporting on schools done already – somebody just has to get creative in the packaging and marketing department. Granted, the process would take a while to complete, but once all the baseline budgets have been reviewed, it would be fairly easy to compare those areas in which spending is out of control relative to what the students get, graduation rates, length of time. etc. In the long run, it would help public institutions, I believe. There's nothing inherently awful about state colleges except they don't have towers made of real ivory like the ivy league schools. (I'm joking!) More and more folks are going to go to state colleges anyway because of price, so why not start there?

   I don't see a dilemma for Libertarians; I see a challenge for entrepreneurs.

   — 2 cents worth · Jul 20, 06:37 PM · #

2. There is no silver bullet for containing costs. Like the healthcare debate, however, there are several places to start unturning stones. Derek Bok notes in his "Our underachieving Colleges…" that spiraling costs are mostly due to adminstration. When you factor the growth of student services, disability services, diversity services, etc. it has ballooned the cost of running a school. Second, the pursuit of US News rankings really means that schools recruit the best faculty so they can publicize their credentials and research. This occurs while they waive them from teaching courses, which many noted scholars do not like to do. At large universities there are great scholars walking past classrooms where TA's and adjuncts actually teach undergrads. Unfortunately, very little of this scholarship is monetized to benefit the school. Finally, educational institutions, despite US News, are hard to compare to one another. This makes it impossible for schools to position themselves as the low-cost alternative. No school wants to begin offering lower tuition because parents and students begin to ask, "why are they

cheaper", there must be something missing or wrong. No "new" schools and few schools going out of business means a stagnant competitive environment. Information will not change this. Unfortunately, it will take the will of the people, producing an effect on their legislature, to solve this. That would be the same state legislature that asks for free State U football tickets and counts many legislators as grads. Federal regulation, despite my libertarian leaning ways, is starting to look good.

— ProfK · Jul 20, 10:08 PM · #

3. That's Robert Martin, not George Martin.

   — Dan · Jul 21, 07:46 AM · #

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