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Why Price Controls Are The Best Way To Keep College Affordable

By: Josh Freedman, September 5, 2013

Every time a person uses the phrase "price controls," I'm fairly certain the fire alarm goes off at the Cato Institute and the soundtrack to "Requiem for a Dream" starts playing in the lobby. A bunch of policy interns saddle up horses and ride through Washington holding lanterns to alert all of the members of Congress and the news media that someone has proposed the idea.

Yet the best plans for actual higher education reform are centered on exactly that: a system of regulations to control prices. Last week, President Obama proposed to tie federal financial aid to colleges' performance based on a new college ratings system that takes into account the number of low-income students in attendance, tuition prices, and even outcomes like graduation rates and future earnings of students. Yet the President stopped short of more overt price controls, instead preferring to use the college ratings system only to provide incentives to schools that perform well.

The response from many policymakers and college officials has been to cry foul at the government going too far to intervene in the economy.

The President's plan, however, doesn't go far enough: if we want to tackle the skyrocketing cost of higher education, price controls are the best option we have for keeping college affordable. [Cue fire alarms at Cato].

This idea might sound radical, but it's not new at all. Rather, it looks eerily similar to a 2003 proposal by Republican House Members – including John Boehner – that called for a "College Affordability Index" and threatened to eliminate federal subsidies for schools that failed to improve their status. It can't be *that* radical of an idea if House Republicans were the ones that were pushing the idea a decade ago. Nor are these types of regulations a new idea in the economy at large: prices for public utilities like electricity and water are set by the public sector, as are the fee schedules for Medicare.

Neither President Obama nor John Boehner will ever use the phrases "price controls" or "price regulation." The phrases elicit a rather unpleasant visceral reaction, akin to the smell of a well-aged stilton. But they are crucial. Tying federal subsidies to *something* and using public leverage to stop the upward pressure on prices would finally get at the root causes of price increases in higher education.

As I wrote yesterday, we are going to have public subsidies in higher education. We fundamentally want and need a public presence in the provision of higher education.

But if we're going to have to subsidize higher education in some form, the worst way we could do it is how we're doing it right now: an unlimited government spigot and few controls on where the money is going. (The bucket analogy is apt here: the government is pouring water into a bucket but has no control over how big of a hole is being drilled in the bottom of the bucket). Even if we give colleges the benefit of the doubt and assume that their minds and hearts are in the right place, there are too many pressures in the system to encourage them to try to maximize their revenue and spend increasing amounts of money.

One proposed option to deal with this is to simply increase the amount of information available and let students and families use this information to make "better" decisions about where to attend school. If this works properly, students will reward schools that provide a better value education and punish those that charge high prices and don't follow through.

More information can't hurt, but it won't solve the problem either. As analysts from all sides of the political spectrum have noted, there is a fair amount of data already available. The federal government has a College Affordability and Transparency Center that publishes annual "watch lists" of colleges with huge price increases, and the Bureau of Labor Statistics and companies like Payscale offer information about what fields of study offer higher salaries later on. Yet this data has not done very much to stem the price increases because the information is often too complicated and even when it is available is usually not heeded strongly enough. My colleague Ben Miller notes, "Transparency is a good thing, but it's an incomplete and insufficient solution." Other proposals favor more complicated regulations to get around the technicalities of price controls. Arthur M. Hauptman, writing a brief for the American Enterprise Institute, suggests forcing schools to discount costs for low-income students. Legislation would require that schools that increase tuition also increase their financial aid by a given amount as well (he suggests 50%). In other words, he is proposing a system of enforced means testing to prevent schools from raising prices and passing the buck.

This is a reasonable suggestion, but it's not guaranteed to solve the problem. Unless schools have to cover most or all of the cost of the financial aid increase, rather than just a small portion, it will still be in the school's interest to raise prices. If this is the case, net prices even for low-income students will increase, albeit more slowly than they would without the added regulation. More importantly, this plan is subject to all of the same criticisms as price controls are while being more complicated.

Finally, many commentators have suggested simply asking the schools to play nice. This is suggested with surprising frequency, and often in a tone of voice that means we're really serious this time. Unfortunately, it's not particularly useful. Even if schools are not bad actors, the pressures and incentives in the system still exist to drive prices upward.

What's left is price controls – or, metaphorically, fixing the size of the hole in the bucket. This strategy covers other factors contributing to price increases in higher education as well: price controls also put the kibosh on the continual pressure to invest in non-academic spending. (It cannot deal with reductions in state subsidies for public schools, however, unless the control mechanism is related to state subsidies. Which, Benjamin Landy argues, it should be).

The crux of a price control proposal (or Obama's plan or even the pre-Tea Party House Republican plan) is utilizing the federal government's leverage. By tying federal subsidies, such as grants and preferred loans, to slowing costs of college, the government can ensure that access increases while costs come down.

Does the government have enough leverage to make this work? The government has surprising power over both the public and private sectors because of the sheer amount of federal aid is dispensed. In total, 57 percent of all undergraduate students had some form of federal financial aid (called Title IV aid). The average amount of federal aid is highest for students at private institutions, meaning that private schools, like public ones, are affected by policies to slow the price of college. As my colleagues at the New America Foundation write, "Title IV aid [...] is the lifeblood of most institutions of higher education." Only a very small number of the wealthiest of the wealthy schools with huge endowments and fewer borrowing students will be unaffected by regulations on prices.

It is important that the system of controlling college costs includes both public and private schools, and a well-designed price control system can do this. Individual public cost caps, which could take the form of a variation of either Texas' $10,000 tuition plan or Oregon's Pay-it-

Forward no-debt option, only affect public institutions. By capping public costs but continuing to let private (and still subsidized) college costs increase, we would be putting public institutions at a competitive disadvantage. If anything, many public schools face too little funding, particularly 2-year universities and community colleges, especially as they educate a wider variety of students and receive decreasing levels of support from the state. (State funding for public community colleges has fallen so fast since 2007 that tuition is increasing even though these schools are actually spending *less* per student). A system to control costs has to address both the public and private sides of the system; tying price controls to federal subsidies achieves this because subsidies exist, and will continue to exist, for all parts of the system.

The main argument against price controls is that colleges will find ways to game the price control metrics and fail to stem price increases while creating adverse incentives that could push out low-income students. While colleges facing new regulations – just like banks facing new financial rules or businesses operating in the face of new environmental standards – will of course try to find ways around these obstacles, all solutions to the cost control problem face this issue.

This is an understandable criticism, but it is one that could apply to every regulatory solution. If adverse incentives are a problem, schools under Hauptman's enforced means testing policy are even more likely to shy away from enrolling low-income students than they would be under most systems of price controls.

Yet we obviously need regulation: as the entire last post detailed, the government needs to play a role in providing access and, as noted above, only providing more information and hoping the system fixes itself is unlikely to be enough. Luckily, a well-designed set of price control metrics can minimize these problems. As long as it is flexible, adaptable, and actually endowed with enough power to follow through with its goals, a system of price controls can be created to be lithe enough to keep the system pointed in the right direction.

This is not to say the process will be easy. But we know where to start: the three areas that the President identified as key indicators – access, affordability, and outcomes – are designed to ensure that price increases can be kept in check while avoiding the adverse incentives that Hauptman warns of. More specifically, at Inside Higher Ed, Miller runs through the basic structure of how a system could be set up to maximize the effectiveness of the cost control mechanisms. Key components will include grouping like institutions together to account for differences in student populations and ensuring that schools are rewarded, not penalized, for promoting access to students of all backgrounds.

Nonetheless, with his new proposal to limit price increases by tying them to federal subsidies, President Obama is finally pushing our discussion of higher education in the right direction. He should go further, however. A system of price controls is not that radical: John Boehner and other Republicans agreed just a decade ago before regressing to their current intractable anti-government stance. We can't de-subsidize higher education, so our best option is make the subsidies actually work. It's time that we finally learn our lesson, rid "price controls" of their stilton-esque odor, and get serious about lowering the price of higher education across the board.