

The New York Times

Give It a Profit Motive

By Andrew J. Coulson – July 9th, 2013

Milton Friedman proposed investing in future earnings to finance higher education in the 1940s and 50s and the idea was rekindled in 2002-03 by Miguel Palacios. As Palacios explains, these contracts can have important advantages over traditional loans, but only if they are thoughtfully implemented. To be sustainable from a policy standpoint, the average lifetime payback must at least cover the cost of the contracts. But to remain affordable to students, the extent to which the average payback exceeds the average cost must be minimized.

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How can those goals be achieved simultaneously? First, with good information. The future earnings of each graduate must be accurately estimated using data on the quality of the college, the student's previous performance, salary projections for their intended field, and the likelihood that they will actually work in that field. Second, there must be incentives to ensure that entities issuing the contracts set the payback terms only high enough to ensure sustainability.

To do that, you need the profit-and-loss system of the private sector to encourage good (and penalize bad) data and forecasting. And you need competition among multiple independent contracting entities to exert downward pressure on the cost to students. The Oregon plan currently seems to lack both, opting instead for a single government contract issuer. Unless Oregon eschews its centrally planned approach and opts for a marketplace with the necessary incentives, checks, and balances, it is apt to disappoint.

One final note. Even a thriving human capital marketplace will not bring our higher education system into the modern world. Thanks to the Web, social media, and associated gadgetry, independent learning is easier and less expensive than ever before. Coupled with judicious internships or part-time work, and interactions with other students and scholars, it can lead to more skilled, mature and experienced "graduates" than those who take the traditional college route—while leaving students with little or no debt. In light of this, it is hard not to think of traditional higher education as an anachronism.