SYMPOSIUM

The Economics of Higher Education

The Papers

Thomas J. Kane
College Cost, Borrowing Constraints, and the Timing of College Entry

Sandy Baum
The Distribution of Subsidies to Postsecondary Students

and Jane Sjogren

Michael S. McPherson,
Indirect Cost Recovery Rates: Why do They Differ?
Morton Owen Schapiro,
and Ian G. Smith

Introduction

Sandy Baum
Skidmore College

Although economists have long recognized the contribution of education to productivity and earnings, the financing of higher education has received limited attention from the profession. As funding for public higher education gets squeezed in state budgets and as the spiraling cost of attending private colleges and universities attracts public attention, questions of institutional finances and of how students pay for college will become increasingly significant. The papers in this symposium address diverse aspects of the college financing quandary.

The problems of students and families paying for college have been widely discussed in the popular press, but economic analysis of the options available and the choices students make is still limited. Many receive grants and loans from federal and state governments, as well as from colleges and universities. While most of these direct subsidies are based on financial need, an increasing proportion are linked to academic merit or to other student characteristics deemed desirable by institutions.

Thomas J. Kane's paper focuses on the loan component of student aid. Many discussions of student loans focus on whether students are being forced to borrow excessively, generating inappropriately burdensome repayments and creating a barrier to attendance. Kane approaches the question from the opposite viewpoint: Are loan limits too low? He finds that certain groups of students are more likely to delay


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college entry in high-tuition states and argues that borrowing constraints contribute to this phenomenon.

Less visible than grants and loans are the indirect subsidies students receive in the form of discounted tuition, which does not cover the full cost of education. It is well known that students at public colleges and universities are subsidized by taxpayers in their states. The decline in these state subsidies has contributed to a relatively rapid increase in tuition levels in the last few years. The indirect subsidy in private colleges and universities is less visible, but equally real. Most institutions supplement tuition revenues with earnings from endowment and/or ongoing private giving.

The paper by Sandy Baum and Jane Sjogren examines the distribution of both direct and indirect subsidies to college students. They find the difference in income distributions of the students between the public and private sectors is less than is commonly believed, and they document differences in the distribution of subsidies in the two sectors. Their results are relevant to a number of public policy issues, including the implications of funding low tuition as opposed to student aid and the extent to which private higher education institutions may ease the strain on public budgets.

The stress on families and students attempting to finance college is a direct result of rising institutional costs, in addition to trends in family incomes and expenditure patterns. Economists studying higher education finance are concerned not only with college choice and payment options, but also with how institutions operate and how they are financed. One particularly interesting approach to this issue is to compare educational institutions to other types of firms. There are, of course, many similarities. But the reality that the consumers of higher education (the students) are a major input into the production process creates some interesting circumstances. Few firms turn away customers who are willing to pay for their products, but colleges must do so in order to maintain the quality of their educational experience.

The quality of the product is, of course, very difficult to measure. One of the more controversial aspects of this quality question is the extent to which teaching and research are complementary activities and the extent to which they compete for faculty time and for institutional resources.

In their contribution to this symposium, Michael S. McPherson, Morton Schapiro and Ian G. Smith address one aspect of the relationship between the research function and institutional costs and revenues. They explore the indirect cost recovery system, which governs the rate at which universities are compensated for overhead expenditures resulting from federal research projects. Public attention has focused on cases of institutional abuse of this system and the wide variation in reimbursement rates granted to different institutions has tended to raise suspicions. McPherson, Schapiro and Smith find that there are good economic reasons relating to differences in the mix of operations, the financial characteristics, and the location of institutions for much of the observed variation in reimbursement rates.

All of these papers, like much of the recent work in the economics of higher education, examine issues which are receiving attention in the media and in political arenas. Unfortunately, the dialogue between economists and others with an interest in this policy area has not been sufficient. For example, while parents, students and politicians complain about high levels of student debt, economists argue the efficiency of student financing of the investment in human capital. In order for the economic arguments to influence the policy debates, they must be informed by institutional, social, and political realities and communicated effectively to decision-makers. Higher education pricing and financing are likely to be prominent public policy issues in the coming years and more research from economists on these issues will be increasingly important.