

RICHARD VEDDER AND THE FUTURE OF HIGHER EDUCATION REFORM

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In the 2001–02 academic year, when Richard Vedder was beginning his work on the causes and consequences of rising costs in higher education, the average cost of a single year at a four-year university was \$17,418 (including tuition, fees, and room and board). In other words, for every bachelor’s degree awarded, somebody—whether the student, his or her parents, the donor of a scholarship, or the federal student loan program—was paying something around \$69,672. Since then the price of college education has risen sharply relative to the prices of other goods and services. Average tuition for the 2011–12 academic year was \$23,066—an increase of 32.4 percent in only a decade, compared to a 27.6 percent cumulative rate of inflation over the same period.¹ With the cost of a four-year college education now approaching \$100,000, Vedder’s project has only grown in significance.

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¹Average tuition statistics are from Table 381 of National Center for Education Statistics (2013). Inflation calculated from Table 24 of the August 2014 CPI Detailed Report (Bureau of Labor Statistics 2014).

Further, despite the increase in costs, the quality of college education appears to have flat-lined. Based on historical trends in performance on the Graduate Record Examination (GRE), frequently taken toward the end of college by those students considering graduate-level education, Vedder (2004) concludes that the quality of education received by the average student, although difficult to measure, likely has not changed much over time. He also examines literature that asks whether education is intrinsically valuable or valuable primarily because it assists people in signaling credibly that they are sufficiently competent to be employable. His conclusion—that student performance on standardized tests is stagnant and that diplomas and degrees are valuable, but not because of the learning they represent—damns the whole educational system with faint praise. If not for better educational outcomes, why exactly are we directing more and more of our scarce resources toward the university system?

The nature of the current educational system invites another qualitative concern. Calls for all students to have the same experiences at both K–12 and postsecondary institutions of learning implicitly assume that the optimal basket of courses, interactions, and skill sets is the same—or at least quite similar—for every student. Yet the idea that diverse people, who will contribute to society in a wide range of ways, all require the same training is a spectacular leap of faith, and those who promote it have not yet met the burden of proof. Today's higher education system exhibits a failure to recognize either the purpose of postsecondary schooling or the potential alternative means of generating the same outcomes and social benefits. The traditional model is only one of many possible ways to encourage education, culture, and innovation. By exploring other alternatives, it may be possible to raise the quality of education and scholarly research while getting costs under control.

This article proceeds as follows. First, we describe the problem of rising costs in higher education. Second, we consider the array of potential alternative means for providing the benefits generally attributed to college educations and scholarly research. Third, we discuss the possibility and likelihood of reform. Finally, we conclude with an appreciation of how Vedder has helped us better understand these questions.

The Rising Cost of Education

Why is the cost of higher education rising so rapidly? The increase in the price of a college degree is explained at least in part by demand-side considerations. First, rising incomes mean that the populations of developed nations now have greater demands for all normal goods, including the services of institutions of higher education (Vedder 2004). Second, preferences have shifted toward more prestigious educational experiences, leading well-meaning family members to emphasize four-year colleges over junior colleges or trade schools (Vedder 2004). Third, the untested assumption that a four-year college degree has become essential for young people to succeed in an ever-more technologically sophisticated global economy has motivated public policies that subsidize higher education, further shifting out the demand curve. All of these factors contribute to the number of people applying to institutions of higher learning, thereby enabling universities to charge higher prices without risking declines in enrollment.

These “demand-induced pressures to raise tuition” are “aggravated by the non-market-driven nature of higher education” supply (Vedder 2004: 39). University attendance is, of course, not compulsory and, as such, is subject to some degree of market discipline (Vedder 2004). However, universities have been remarkably successful in avoiding exposure to the market test.

In a standard competitive market, the chain linking consumption decisions with production decisions is strong. If consumers embrace a product, the producer will earn a profit and thereby be encouraged to expand output. If consumers reject a product, the producer will be forced either to redeploy resources to some other productive activity or go out of business altogether. This loss side of the profit-and-loss equation is the burly, no-nonsense bouncer of the market; lose too often and your ability to participate on the supply side is revoked.

In the market for higher education, however, the chain linking production and consumption decisions is weak. Individuals who are not residual claimants of university profits make many decisions. The job security and compensation packages of administrators and faculty, particularly those with tenure, are tied to revenue only indirectly and only in the long run. They stand little chance of capturing any of the excess profits that might be generated by their efforts and, as such, face few costs if they pursue objectives other

than the quality of the educational experience they provide to undergraduate and graduate students. Of course, most industries struggle to evaluate the extent to which any given individual employee contributes to the bottom line. The position of the average rank-and-file faculty/staff member might not be so different from the rank-and-file employee in most large corporations in this regard, if it were not for some significant confounding factors: the difficulty of monitoring faculty performance, the third-party payer system, and the extent of subsidization of the university and its many diverse programs.

Faculty performance is notoriously hard to evaluate. The high degree of specialization within the academy makes it difficult for faculty to evaluate each other's contributions to institutional research and teaching missions. Consequently, hiring committees, department heads, and administrators tend to put more emphasis on quantity than on the quality of publications. Evaluating the potential of a research product to influence the state of knowledge within a field is simply too difficult. Evaluating teaching performance is similarly challenging. The student course evaluation is the primary method of monitoring classroom teaching at most universities, but recent scholarship suggests that the intrinsic worth of student evaluations is overrated. A 2010 study of student evaluations at the United States Air Force Academy (USAFA) found that student evaluations are positively correlated with student performance during the current course, but negatively correlated with student performance in future, related courses (Carrell and West 2010).² This finding is consistent with research demonstrating that charismatic presentation of course materials is correlated with perceptions of learning, but not actual learning (Carpenter et al. 2013).

The already difficult task of evaluating contributions to learning and knowledge is further exacerbated by the third-party payer system. The third-party payer system creates a significant and multifaceted principal-agent problem within higher education. The undergraduate student—the principal—may fund his or her own

²At the USAFA, students are assigned randomly to faculty and required to continue along particular academic tracks regardless of the interest in the subject generated by the instructor of the first course. Further, if multiple teachers are offering the same class during the same semester, they all use the same syllabus and administer the same examinations. This means that data from the USAFA on student performance within courses and in related follow-up courses is significantly more comparable than similar data from other institutions (Carrell and West 2010).

education directly, but he or she is more likely to arrange payment by contracting with one or more go-betweens. According to Sallie Mae's 2014 report, *How America Pays for College*, 31 percent of educational expenses are financed through grants and scholarships, and 41 percent of expenses are paid by parents or other benefactors. Those who experience the product and make the primary purchase decision—the students—pay only 27 percent of educational expenses. Furthermore, over half of these student-paid expenses are financed by borrowing at rates far below those most students would be able to obtain on an open market given their credit histories and likelihood of repayment (Sallie Mae and Ipsos Public Affairs 2014). In other words, for every \$1,000 dollar increase in costs, the average student is on the hook for only \$270, and only \$120 of that \$1,000 comes out of his/her pocket. The rest is borrowed on favorable terms with more or less unlimited time to repay. This loose connection between the payment for and the provision of the service dulls the market impact of tuition increases and fee hikes.³

Subsidies by state and federal governments and nonprofit organizations also obscure the market value of education and hamper competitiveness within the educational system. In 2013, 40.4 percent of public university revenue originated as federal, state, or local governmental appropriations, grants, or contracts. Private universities received 12.6 percent of their funding from these sources; in the for-profit university sector, that figure was 5.7 percent of revenues (Ginder and Kelly-Reid 2013). The tax-exempt status afforded universities is another form of subsidy. Like all nonprofit organizations, universities are eligible for a number of tax incentives that are not available to others. Similarly, many contributions to universities are tax deductible for donors. This acts as yet another mechanism diverting resources toward the university system and away from other types of investment, regardless of the value created for students or third parties by the particular university or program.

Subsidization occurs within universities as well, in the form of using revenue from profitable programs to fund unprofitable programs. This cross-subsidization comes in many guises. Popular majors subsidize unpopular majors; undergraduate education

³Vedder likens the payment structure in higher education to that in health care, where third parties, such as insurance companies and taxpayers, foot most of the bill (Vedder 2004: xvii).

subsidizes graduate education; and academic programs subsidize athletic programs (Vedder 2004). Vedder also suggests that the high price of university-provided food and housing services relative to off-campus alternatives may be evidence that commuting students are being subsidized by those living on campus. The fact that many schools monopolize the on-campus food and beverage market for themselves when chain restaurants or local eating places would be more than happy to provide a higher quality product at a lower price is further evidence that the university is getting something extra out of their resident student services—specifically, they are getting subsidies for other programs. This kind of cross-subsidization allows the persistence of programs that various customers—whether students, research funders, or sports fans—would not be willing to purchase if they were required to pay full cost.⁴

Ultimately, whether the budgetary cushion takes the form of student aid, tax breaks, or private fund raising, the effect is that universities can increase what they are charging without much risk of scaring away their customers. Thus, Vedder (2004: 21) notes that efforts to make college more affordable may be “ultimately self-defeating.” To illustrate, one study finds that although state appropriations increased by 40 percent and federal aid increased by 200 percent between 1986 and 2007, enrollments during the same period increased by only 40 percent, while tuition rose by over 90 percent (Gillen 2010). The implication is that subsidization is not reducing tuition costs and may even be contributing to their growth. In other words, policymakers have ignored Gordon Tullock’s advice—not for the first time—and created a transitional gains trap in which the removal of subsidies is prohibitively costly despite the fact that they create little or no long-term benefit (Tullock 1975). Funds that are intended to offset students’ costs are instead absorbed by the higher education system in ways that make education more expensive for the next cohort, leading to calls for further subsidies, which in turn cause further tuition inflation—and on and on it goes in a perpetual cycle of lessening affordability in the name of charity and equal opportunity.

⁴Reforming the practice of cross-subsidizing athletic programs is a particularly difficult problem to solve. See Denhart, Villwock, and Vedder (2010) and Shughart (2010).

Possible Alternative Systems

Vedder's research raises a question—why is it that we need these things called “universities” anyway? What is the purpose of higher education? Only by first answering this question can we determine whether or not better, more efficient ways of achieving the same goals can be found.

Vedder (2004: 116) writes that, “the vital, noble mission of maintaining our civilization is the main job, sometimes almost the only important job, of universities.” The benefits of new knowledge accrue broadly, and a community that can read and write with mutual understanding will face significantly lower transaction costs when attempting to cooperate voluntarily for mutual gain (Vedder 2004). Furthermore, economic growth, and therefore the preservation of human society as we recognize it today, depends upon the continuous maintenance and generation of “our human and cultural capital stock” (Vedder 2004: 116). In other words, communities have an interest in preserving the knowledge and skills required to produce at a level that will at least maintain their current standard of living or raise it. This and similar arguments are often used to justify government spending on universities as a public good, or at least as a good that generates positive externalities for society as a whole. Not only are the benefits of an educated populace, once produced, available to all at zero marginal cost, but the nonexcludable nature of many of those benefits (such as the acquisition of pure scientific knowledge, engineering know-how, and a more cultured, better informed and cosmopolitan population) makes it nearly impossible to exclude those who do not wish to contribute to financing institutions of higher learning. Consequently, so the argument goes, people in an open market would rationally choose to free ride on the educational support provided by others, resulting in underprovision (or no provision at all) of a valuable public good.

This traditional view encounters three problems. First, higher education may not be as beneficial for the public at large as we think. Given the arguably negative impacts of the current higher education system—namely that students and taxpayers are deeply indebting themselves to provide a service that may not supply much beyond its signaling value—universities actually may generate net negative externalities by misallocating resources (Vedder 2004). Second, even if the external benefits to education are on net positive, they may not

be positive at the margin. This can occur if top students, rather than marginal college attendees, generate the bulk of education's positive spillovers (Buchanan and Stubblebine 1962, Hall 2006).

The third and perhaps most difficult-to-overcome challenge to the traditional view is that even if higher education does generate positive externalities on the margin, subsidization and other forms of public provision are not always the best way to encourage production of public goods. This can be the case if components of the public good are actually private goods, if the extent of government failure exceeds the extent of market failure, or if there are significant offsetting unintended consequences (Shughart 2011). All three of these situations plausibly apply to higher education. Public institutions provide many private goods, meaning that one person's consumption of the good reduces the stock available for others to consume, and that access to the good can easily be limited to those who are willing and able to pay. Food services, lodging, and fitness centers are obvious examples of goods that are regularly and without difficulty provided on the private market, often at better quality and lower cost. Many of the components of instruction may also be best conceived of as private goods. If one of us aids a student with a thesis project, the benefit accrues primarily (if not completely) to that student, and we have less time available to help others or to contribute to other activities.

A public good can also be a "bad public good" (Shughart 2011) if its provision is associated with significant government failure or unintended negative consequences. No human institutional design is ideal, and so alternative ways of providing higher education should be evaluated as they truly are, not as they theoretically could be. Given that no solution will work out perfectly, the only alternative is to select the option that will be the least imperfect. Or to put the point more generally, cats can be skinned in many different ways and, all else being equal, the least-cost method always is preferable. For any given alternative productive arrangement—public, private, or somewhere in between—one encounters both external costs associated with the good produced (in this case, the costs are the positive or negative externalities associated with higher education) and decision-making costs (the costs of providing that good through a particular organizational structure). The optimal mode of provision will be that which minimizes the sum of decision-making costs and external costs (Buchanan and Tullock 1962). The usefulness of this theoretical

approach has been validated empirically by strong evidence that so-called public goods are often provided more efficiently by individuals or local cooperatives (Coase 1974, Ostrom 1990).

What are the alternative methods that could be used to generate the public goods usually thought to characterize institutions of higher learning? We do not presume that we or anybody else could conceptualize all of the possibilities, but we will consider here three different approaches: (1) continued public support and regulation, but under a different set of rules; (2) public support of a deregulated and privatized educational system; and (3) decentralization of both the funding and provision of higher educational programs.

Public Funding, Public Provision; or, Reform from Inside Out

The least radical alternative to the current higher education system is to preserve the current structure of primarily public funding and provision,⁵ but to alter the incentives of the system from the inside. This approach to reform views effective bureaucratic organization as posing challenging but soluble problems (see, for example, Glazer and Rothenberg 2001). According to this view, it is simply a matter of getting the incentives right—do that, and effective public funding is possible.

An example of this type of reform might include tying administrative compensation to university rankings. Since one of the reasons universities can afford to make bad decisions is that the decisionmakers have no profits on the line to lose, such an attempt to approximate a market signal could introduce a degree of accountability into the system (Vedder 2004). However, whether or not this policy will produce desirable outcomes depends upon the way in which rankings are calculated. If university rankings are effectively able to measure the quality of education and knowledge growth (that is, value added for students), then we can expect greater attention to rankings to yield positive results; if university rankings measure variables that are irrelevant to or undermine the objective at hand, then we can expect greater attention to rankings to be disastrous. For example, spending

⁵Seventy-two percent of postsecondary students are enrolled in public institutions (National Center for Education Statistics 2013: Table 219); 57.3 percent of undergraduates received federal student aid at an average funding level of \$8,200 per student; and 15.4 percent of undergraduates received state student aid at an average funding level of \$2,700 per student (Radwin et al. 2013: 9–10). We believe this qualifies our current system as primarily public in nature.

per full-time student accounts for a full 10 percent of a university's score in the college rankings issued by *U.S. News & World Report* (USNWR) (Morse 2014). As such, an incentive that encourages attention to USNWR may be more likely to encourage than to discourage bureaucratic bloat. Moreover, it is widely known that university administrators both know how USNWR's rankings are constructed and "massage" the information they supply to the magazine so as to move up the list. Sauder and Espeland (2007), to cite one relevant study, report evidence that administrators redistribute resources—by, for example, shifting money from need-based to merit-based scholarships—in order to maximize their positions within the rankings. The more the system is gamed, the less meaningful the rankings are and the greater is the potential for unintended consequences.⁶

Tenure—the customary practice of allowing more senior faculty members to bless the peers they deem to be sufficiently credentialed with the near promise of lifetime employment—provides another example of the difficulty of internal reform. Controversy over the value of tenure abounds. On one hand, tenure is lauded as protecting academic freedom (Carmichael 1988); on the other hand, tenure makes it difficult to remove underperforming faculty or to reallocate instructional resources from less popular to more popular majors. Consequently, tenure can breed stagnation rather than the innovation it was designed to foster. Moreover, a junior faculty member's immediate colleagues are one of the key determinants of whether or not he or she will be awarded this particular prize. The result of this reliance on intradisciplinary success often discourages faculty from investing in teaching or engaging with those in other disciplines. Vedder (2004: 77) argues that "this is bad for students, bad for scholarship that has broad social meaning, and bad for developing a university community that has common meaning."

If Vedder is right that tenure is bad for academic communities, then why does it persist? A university's choice to continue the practice of tenure is, after all, voluntary. Even for the purposes of accreditation, which is not always required but does have implications for federal funding, accreditation bodies often care more about the

⁶USNWR's rankings would be characterized as "high-powered" incentives in the literature of contracting. They are salient for administrators' prestige even if they may be unrelated to educational outcomes for students.

stability of the faculty than about how that stability is maintained. Tenure is only one way of doing so, and if it is at odds with students' educational outcomes and the advancement of knowledge, then it would seem foolish to turn the control of such a significant portion of the economy over to groups of faculty and administrators who are governed by its incentives. Nevertheless, universities have adopted tenure systems for hundreds of years. This stability, and the fact that the beneficiaries of tenure are those in the strongest position to ensure its continuance, suggests that significant change in such practices is unlikely to come from within the university system.⁷

The bottom line is that improvements in the publicly funded, publicly provided university system are difficult and downright unlikely. Even if designing good rules were possible, strong forces are at work within the university that would prevent their adoption.

Public Funding, Private Provision

A second alternative means of providing the benefits associated with higher education is to continue public subsidization, but shift to private production. Programs that are publicly funded but provided by private agents are commonly referred to either as outsourced or privatized. Outsourcing can be efficient because sometimes the costs associated with negotiating an external contract actually are lower than the transaction costs associated with internal organization (Coase 1937). One way to think about privatization or outsourcing of higher education is to identify particular functions within universities that can be privatized (Holian and Ross 2010, Vedder 2004). The clear first candidates for outsourcing are those goods that really are private rather than public in nature—such as housing, food, cleaning, groundskeeping, and building maintenance. These could be outsourced rather than produced internally by, as is the case in many public institutions of higher learning, full-time government employees.

One of the reasons why bureaucratic provision of on-campus food and lodging is inefficient is that the people in charge are not residual claimants of the profits generated by their efforts (Kerekes 2010).

⁷One creative solution Vedder offers is to make tenure an optional part of faculty members' compensation packages. This could be beneficial in that some faculty, particularly those who are confident about their abilities to perform, may prefer additional salary or other nonwage benefits to tenure if given a choice (Vedder 2004).

The bureaucrat's primary allegiance is not to minimizing cost at any given level of quality, but instead to making themselves and their superiors look good (Tullock [1965] 2005). This is more likely to involve increasing rather than reducing spending. Consequently, shifting to a private provider who must compete for the contract can reduce costs, if the contract supplies the proper incentives to both parties. University administrators are not likely to benefit themselves by choosing a higher cost or lower quality provider if all else is held constant. Unfortunately, however, all else rarely is held constant. The same bureaucracies that currently manage the monopoly versions of these services usually have a say in selecting the private contractor.⁸ Consequently, the same preference for high-quality over low-cost products may persist, as in most situations in which an individual is choosing a product for which someone else will have to pay. In other words, privatization is not really a choice between bureaucratic and market provision—it is a choice between two different types of bureaucratic provision.⁹

Another, more comprehensive way to think about privatization within higher education is to outsource the entire system. The most familiar proposal for such a reform is a voucher system. In a voucher system, subsidies go directly to students who are then able to choose where they would like to spend the money (Vedder 2004). Milton Friedman ([1962] 2002) famously advocated such a system for K–12 education, but vouchers could function in a similar manner at the higher education level. Various G.I. bills enacted since the end of World War II have enabled millions of demobilized armed forces veterans to earn undergraduate and graduate degrees at colleges of their own choosing. Such a system has the advantage of providing support for those who would not otherwise be able to afford higher education while still preserving some degree of market competition among universities. However, since the cost to the individual student is still being offset by public support, the ability and incentive of colleges and universities to spend at greater-than-optimal levels will persist. One way around this is to create a binding constraint on the

⁸The incumbent on-campus public enterprise is often allowed to compete for the right to continue to provide the good or service, but care must be exercised in evaluating such proposals against those submitted by private contractors because the on-campus incumbent typically does not maintain a separate capital budget.

⁹Boettke, Coyne, and Leeson (2011) make a similar point in the context of the debate over competitive governance.

dollar value of the voucher. If the voucher's value were allowed to rise indefinitely, the system would impose little cost-controlling discipline. On the other hand, if the initial value of the voucher is tied to inflation or some other strict (and readily observable) cap, then spending can be kept within bounds (Vedder 2004).

One advantage of the voucher system is that it allows politicians to take action on higher education reform without going further down the regulatory rabbit hole. Proposed regulations include setting a tuition price ceiling; taxing tuition charges above a certain level; adjusting the set of tax benefits currently received by not-for-profit universities; or mandating specific cost reductions through policies such as establishing minimum teaching loads, maximum administrative salaries, or spending caps for nonacademic programs (Vedder 2004). Such targeted regulatory efforts are frequently ineffective because of how easy they are to evade through creative accounting and organizational restructuring. Furthermore, the nature of policy design is that academic industry insiders are often called upon for their advice. This means that higher education representatives will likely have a say in how these policies are designed, enabling them to push for reforms that will impose minimally effective constraints and may even funnel additional rents to the university. A voucher system would mitigate these concerns by turning the problem of how to cut costs over to competing private providers.

However, even a voucher-funding mechanism or some other form of outsourcing does not guarantee a lessening of cost-raising public regulations. Once a government agency has decided to support an endeavor financially, the temptation—some would say moral imperative—to control the quality and equitability of the subsidized project is difficult to resist. One example is Title IX regulations on gender equality in athletic programs. These regulations shape, to some extent, which programs a university is allowed to operate, limiting the range of alternatives that a private market could provide, and are unlikely to go away so long as universities accept any type of public support (Vedder 2004).

Private Funding, Private Provision

The third and most radical alternative—private funding and private provision—actually encompasses a wide range of potential policy choices. From the modern for-profit universities, to trade schools and corporate training programs, to community encouragement of

participation in the arts and sciences, many ways exist for private communities and individuals to improve upon or replace the current educational system.

Is it reasonable to expect private individuals to invest in education? In one sense the answer obviously is yes, because it happens already. The transfer and development of knowledge routinely takes place beyond college classroom walls. Particular skill sets—and the signal that one is competent to employ them—can be obtained by enrolling in corporate or private training programs (Vedder 2004). Even with respect to the advancement of scientific knowledge, the extent to which companies and nonprofit institutes engage in research calls into question the claim that universities perform an irreplaceable knowledge-augmenting function. By most spending-based measures, less than half of basic scientific research is conducted by universities (Vedder 2004). In short, the claim that universities are the only entities that can carry out educational and research missions ought to be rejected. However, the more difficult question—whether universities contribute to research or teaching in ways that could not be duplicated in another lower-cost institutional framework—is not so easy to disprove.

A recently popular alternative to the traditional university system is the for-profit university. These institutions cater primarily to adults, focus on vocational programs and job-skill acquisition, and do not invest much in scholarly research or infrastructure (Vedder 2004). The University of Phoenix weathered the recent financial crisis to remain profitable. Stock in the corporation that founded the school, Apollo Education Group, increased by 1,794.17 percent between January 1995 and October 2014—over four times the growth rate of the NASDAQ composite index.¹⁰ This experience is not unique and has been emulated at for-profit universities of various sizes, structures, and purposes (Vedder 2004). One of the proposed advantages of for-profit institutions is the relative ease with which they are able to explore alternative knowledge-delivery mechanisms, including online distance learning and certification programs (Vedder 2004). For-profit education also has its downsides. Students in private for-profit programs graduate with heavier debt burdens, have higher loan default rates, and are more likely to be unemployed six years after starting college (Deming, Goldin, and Katz 2012).

¹⁰Retrieved October 7, 2014, from Yahoo! Finance.

Observations like these have led detractors to paint for-profit institutions as exploiters who prey upon the disadvantaged, low-income populations who are their primary customers nowadays (Schade 2014). The question remains, however, whether this is a permanent feature of for-profit education, or an artificial effect driven by the subsidization of traditional institutions of higher learning. As their long and varied history demonstrates, no economic or logical constraint necessarily limits for-profit institutions to their current form. There are, however, many reasons to believe that introducing new delivery systems and a better set of incentives into higher education would be beneficial.

For-profit schools have a long and varied history. Schools in ancient Athens were operated on that basis, as were many schools in Great Britain and the United States prior to the mid-19th century (Bennett, Lucchesi, and Vedder 2010). The Industrial Revolution, a period of incredible innovation that changed the face of the world, occurred during a time when there was little public support for education (Vedder 2000). Many reasons have been advanced to explain the rise of public funding in the United States during the latter half of the 19th century. Some claim that public schools were developed out of the liberal democratic ideal of equal access to education; others have noted that public schools were created by people who felt threatened by “new” ideas—such as Catholicism—and wanted to ensure that ideals other than their own were not incorporated into the educational system (Vedder 2000). That motives other than equal access are at play is bolstered further by the fact that neither Vedder nor historical research can identify any significant increase in school attendance coinciding with the shift from private to public funding (Vedder 2000).

Privately run and funded schools could adopt many different governance structures. In *Can Teachers Own Their Own Schools?*, Vedder (2000) explores the possibility of employee stock ownership plans (ESOPs) in K–12 education. If ownership control were in the hands of stakeholders—teachers, principals, and parents at the K–12 level, or faculty, administrators, and students at the university level—then the profits (or lack thereof) would be borne directly by those responsible for decisionmaking. Institutions free of the strings that come along with federal subsidies would be able to differentiate themselves in the educational marketplace. Innovation would not only be possible, but also rewarded financially. All participants

in the system would benefit from identifying cost-cutting measures. In today's system, no benefits accrue to faculty from cutting costs, and students who are funded by third-party payers also receive no benefits from greater cost effectiveness. Although ESOPs can be risky—they put employees at the risk of losing not only their jobs, but also their pensions if the organization goes under—a more direct ownership structure in the higher education system could produce unexpected gains.

An advantage of moving to private funding and provision is that subsidization of the existing mass-market education system may currently be crowding out more cost-effective, higher-quality alternatives. Educational programs and research projects conducted by corporations, private individuals, and nonprofit organizations also generate positive externalities. The benefits of a life-saving technology or a higher literacy rate are not less valuable if they are produced by nontraditional means. So if subsidization crowds out a private alternative, the positive externalities generated by the public option actually replace rather than reinforce the externalities associated with the private option. If some of these private alternatives are more effective than the traditional university system, diverting funds away from them into the traditional system can represent a missed opportunity to generate further positive externalities.

The evidence that higher rates of college graduation lead to economic growth is subject to this caution as well. How does one know that there would not have been more economic growth under an alternative regime with fewer college graduates? If university-based education and research are subject to diminishing marginal returns, the benefit of adding another student to the already massive traditional system may be insignificant relative to the potential returns from shifting bright young people into new, unconventional systems.

Change Is Going to Come

The above comparisons of alternative ways to generate the benefits associated with higher education could, perhaps, be interpreted as an exercise in idealism. Proposing alternative systems is all well and good, but identifying a realistic way of bringing them about is a different game entirely. So now we ask, where are successful calls for reform most likely to originate?

Reform in the supply of higher education could come about in two ways: endogenously, from within the universities themselves, or exogenously, from changes in today's regime of public subsidies and regulation. Exogenous change is notoriously difficult to sustain. The design of reform is complex and usually requires the involvement of experts. This makes regulatory capture a possibility, if not a predictable likelihood. Even if this kind of interest-group influence is avoided, industry insiders can usually identify and adopt ways to get around any given regulation. One effective constraint could come about if increasingly tight state budgets limit the extent to which governments are able to participate in the higher education system as third-party payers (Vedder 2004). Budget constraints may force a degree of market discipline on universities that neither universities nor legislators would be willing to force on the system themselves.

Endogenous change in higher education confronts its own set of difficulties. The decision to stop, continue, or expand any given productive activity within a bureaucracy will be made based not on information about that activity's value to others, but instead on that activity's value to the persistence and health of the bureaucratic organization (Tullock [1965] 2005). One way this tendency manifests within higher education is that universities often have a different perspective on expenses than most for-profit entities. For most firms, finding ways to reduce expenses can be just as beneficial to the bottom line as finding new ways to bring in revenue. Universities, however, are rarely in a position to be able to benefit by cutting costs. While most firms seek to maximize the difference between revenue and expenditure, universities instead seek to equalize revenue and expenditure. Instead of acting with an eye on the bottom line, university budgets are formed by asking the different units on campus how much they intend to spend, adding up those figures, and then compensating for any shortfall by adjusting tuition or efforts in procuring external funding (Vedder 2004).

Universities are also actively pressured not to cut spending by major constituents. Faculties are not only influential in determining expenditures, but also are not residual claimants of any profits the university might earn as a result of greater efficiency. This effect is exacerbated further by the fact that it is often the faculty who choose the administrators (Vedder 2004). Faculty members comprise the group with the most influence over hiring, but the cost of a good or bad personnel decision is distributed across the entire university

population. Credit or blame is unlikely to be connected back to the faculty representatives on the hiring committee and, even if it were, the tenure process means that this knowledge of error is unlikely to result in career or financial penalties. Once again, the distance between the decision maker and the consequences of the decision makes meaningful reform problematic.

Given the difficulty of reform motivated by those on the production side of the education industry, it may be more likely that reform will come through customers refusing to continue to pay the current price for the current product. Relative to a high school diploma, the labor-market returns to acquiring a four-year degree are positive. College graduates have higher lifetime earnings and are less likely to be unemployed. Compare, for instance, the \$34,000 in median annual earnings a high school graduate can anticipate to the \$57,000 median annual earnings for those with bachelors' degrees (Oreopoulos and Petronijevic 2013). However, estimates of the magnitude of the return to education vary after efforts are made to control for innate ability and other potentially confounding factors. OLS specifications using 1995 data suggest that the rate of return to education ranges from a 1.8 percent to a 17.7 percent increase in wages per additional year of schooling, depending on gender and country of residence, with women generally receiving higher returns. The same study found that the average return to education internationally was approximately 6 percent using OLS methods but approximately 9 percent using instrumental variable (IV) methods. Clearly the results of these studies are susceptible to measurement error (Harmon, Oosterbeek, and Walker 2000). However, the returns to the marginal individual may be significantly lower than these numbers suggest. One recent study of a sample from the National Longitudinal Survey of Youth finds that the return to education using a standard IV model is 9.5 percent, but the return for the marginal individual from the same sample is less than 1.5 percent (Carneiro, Heckman, and Vytalil 2011).

Looking forward, these rates of return may not last, particularly if bachelors' degrees become so common that employers can no longer reliably use them as a signal of competence.¹¹ Such a change could lead consumers to alter their perceptions of the worth of a college

¹¹The lifetime earnings gap could also be explained by sharply falling values of high school diplomas, especially those granted by government schools. That issue is a worthy topic of future research.

degree, decreasing the demand for higher education. Even if the perceived value remains high, applications and enrollments could decline because of a slowing population growth rate, restrictions on enrollment of international students, or the market having reached the limit of qualified college applicants (Vedder 2004). All of these forces exert downward pressure on demand and thereby tuition prices.

Another way that the cost of higher education could shrink is that as higher education absorbs greater and greater shares of GDP, calls for reform—and subsequent actual reform—will become more likely (Vedder 2004). Rising costs will also encourage students to pursue alternatives to the traditional higher education system (Vedder 2004). In other words, students and third-party payers may reach the limit of what they are willing to tolerate.

Conclusion

Richard Vedder provides compelling reasons for rethinking the traditional, stale logic behind public support of higher education. The system of subsidization through third-party payers has made education less affordable and in many ways less desirable. Costs are rising, quality is stagnating, and the traditional higher education system has attained a position that is too often secure from challenge and contestation.

However, if those of us within the higher education system genuinely reflect upon the conversation Vedder has brought to the table, we should be feeling decidedly *less* secure right about now, if not downright uncomfortable. Taken seriously, Vedder's work suggests that many of the decisions that university faculty and administrators make on a daily basis may harm the students they purport to help. The growth of administrative bureaucracy, third-party payments through subsidies and loans, and discretionary faculty governance all serve to drive up costs for the consumers of higher education and insulate the providers of higher education from the discipline of the market. Further, the system of subsidies that supports higher education—including private and publicly financed loans to students—makes it more difficult for alternative systems for the production of education and scientific knowledge to compete.

Going Broke By Degree: Why College Costs Too Much (Vedder 2004) and Vedder's other work on higher education supply thorough empirical analyses of the rising costs of higher education. But Vedder

also lays down a bold and exciting challenge. He imagines and then carefully weighs many creative and potentially fruitful approaches to higher education reform. In outlining the broad strokes of three different ways that individuals and groups can support the development and sharing of knowledge—public provision with public funds, private provision with public funds, and private provision with private funds—we have attempted to pave the way for other scholars and analysts to follow in Vedder’s footsteps. By thinking more openly about how to produce the benefits that are traditionally attributed to the higher education system, perhaps there is a way that those of us interested in the advancement of knowledge can better serve our students and ourselves.

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