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# INSTITUTE FOR RESEARCH ON POVERTY

A NEW APPROACH TO HIGHER EDUCATION FINANCE

by

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## DISCUSSION PAPERS

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## A NEW APPROACH TO HIGHER EDUCATION FINANCE

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## ABSTRACT

This paper sets forth a new proposal for financing undergraduate, higher education and explores some of its financial and other implications for Wisconsin. The proposal, called The Higher Education Opportunity Program, is designed to help better achieve the objective of expanding equality of opportunity in post-secondary education, encouraging greater educational diversity and freedom of choice, and making the best possible uses of the resources devoted to higher education.

This program calls for replacing the present system of state undergraduate education grants to public institutions with a system of state grants going directly to students. Public institutions would now derive their revenue from charging students the full costs of college instruction. However, much or all of this increase in tuition would be reimbursed by state grants to lower income students. These grants would be based on the ability to pay the costs of college by student-families.

After describing the rationale for this program and its mechanics, the total costs of the program are estimated, along with the extent to which the costs of college would be redistributed among families at different income levels. The effects of the program on students, the state, and colleges are then analyzed, followed by a discussion of possible adverse effects.

## A NEW APPROACH TO HIGHER EDUCATION FINANCE

Twelve billion dollars of tax funds will be spent for public higher education in 1970. Will the objective of equality of educational opportunity be served by this massive expenditure? Probably not. High school graduates from low-income families will continue to be less likely than others to attend college, less likely to go to high quality colleges, and less likely to remain in college until graduation. This will be true whether we compare all low- and high-income students or whether we focus on only those students who are in the high-achievement groups. Public higher-education subsidies go overwhelmingly to young people from middle- and upper-income families. The result is that equality of opportunity at the college level remains a hope rather than a reality.

Public institutions of higher education have traditionally charged state residents less than the full costs of the education they offer. This below-cost pricing policy has the effect of granting tuition subsidies to all students regardless of their (and their families) ability to pay; in Wisconsin these subsidies now range between \$950 and \$1,300 per student, per academic year. State taxes provide the vast bulk of the funding for these subsidies. This method of financing higher education affects the number and composition of the student body and the distribution of students among institutions in a number of often-unrecognized ways:

--half of the public college students and their families are well-off enough to pay more toward the costs of college education than they do now. Hence, these students have a special inducement to attend public colleges because of the handsome subsidies they receive;

--the other half, who have more limited means, often go deeply into debt, and in some cases even drop out of school because of financial pressures.

--an additional group of academically able young people come from families which are in such dire financial straits that they cannot enroll in college even though tuition is already well below full cost. While this group is small relative to the total number of students, it constitutes a sizeable proportion of young people from lower income and disadvantaged groups.

These effects do not make the headlines in an age of campus turmoil. Yet they are strangely at odds with the aims of equality of opportunity, to which spokesmen for higher education customarily pay lip service. Surely there must be some better system of financing higher education, one which avoids these effects without producing other undesirable effects.

This paper advances a proposal--the Higher Education Opportunity Program--for the financing of undergraduate higher education. The program differs markedly from the widely discussed proposals of the last few years, among them tax credits for parents of college students, direct federal grants to public and private institutions of higher education, and conditional-repayment loans to students.<sup>1</sup>

The program calls for replacing the present system of state undergradutate education grants to public institutions with a system of state grants directly to students. The grants are designed (1) to

offset the limited financial resources of lower income students and (2) to permit them to enroll in either public or private institutions. Public institutions of higher education would now derive their revenue not from the state but by charging all students the full instructional costs of college, much or all of which would be reimbursed by state grants to lower income students. Hence, higher income students would no longer have their educational expenditures subsidized by state taxpayers. This is not to say that such students and their parents are undeserving of public aid, particularly in light of the taxes they pay. But when limited public funds are available, it is essential to allocate them where they are most needed, and this calls for directing the funds to lower income groups--those least able to pay their own way.

Several objectives underlie this proposal. First, and foremost, one of society's major goals is that of promoting greater equality of opportunity, a goal that can be achieved by making post-secondary education and training more generally available. This means that all students should be able to attend a post-secondary school for which they are qualified, without undue financial concern.

Another of society's goals is to promote greater educational diversity and freedom of choice at the post-secondary level. This means encouraging variety in higher education by stimulating competition among institutions (including private schools); it also means expanding students' choice of schools.

A third objective is to make the best possible use of the resources devoted to higher education. To further this objective, the price of college attendance--tuition (which is a price as well as a device for raising revenue)--should reflect the full resource costs of providing college training. If students and their parents are confronted with these full-cost prices, they will make decisions about whether to go to college and about what type and location of college to attend--in full recognition of the real resource-cost implications of their choices. This should lead to a more efficient allocation of resources.

All of these objectives are related. To simply charge everyone full-cost tuition, in the interests of promoting the most efficient use of resources, would deny opportunities for the intellectual and vocational advancement of many able young people whose parents cannot provide any substantial financial help. Similarly, freedom of choice is not enhanced when sizeable tuition differences exist between public and private institutions. Hence, the task is one of developing a plan which simultaneously promotes all three of these objectives--efficiency, equity, and freedom of choice.

The plan proposed here is limited to undergraduate education. While certain features of the plan might be applicable to graduate and professional education, we have not had sufficient time to study this. Our feeling is that the nature of this education, the age of the students, and the complexity of the financial structure all raise serious problems about the direct extension of our proposal to post-graduate education. Neither do we advocate at this time extension of the plan to pre-college

education. By legislating compulsory attendance to age 18, society has, in effect, assumed full responsibility for financing pre-college education.

#### *THE LOW OR ZERO TUITION ARGUMENT*

The belief is widespread that the goals of equality of opportunity can best be achieved by charging low tuitions. Indeed, for many the "ideal" tuition is zero. Low, or even zero tuition, however, does not provide equality of opportunity, for the simple reason that the costs of going to college encompass much more than tuition alone. There are also costs of books and supplies, living expenses and the like, and-- most important of all to low-income families--the several thousands of dollars per year in potential earnings which students forego while in college.

Low tuition, while undoubtedly inducing additional numbers of young people to attend college and serving to keep total costs low for all students and their parents, does a quite unsatisfactory job of facilitating college attendance by qualified young people from low-income families. For them, college attendance is often impossible, even with the financial aid resources now available. The Project TALENT study found, for example, that, among senior high-school students in the highest 20 percent of achievement, 82 percent of those in the highest quartile of Socio-Economic Scale (highly correlated with family income) entered college in the following year; but only 37 percent of the high-achievement seniors in the lowest SES quartile entered college that year.<sup>2</sup>

Much the same pattern emerges from the recent study of Wisconsin high-school seniors.<sup>3</sup> For males from the top intelligence quartile, 90 percent of those from families of high (top quartile) socio-economic levels went to college as compared to about 50 percent from families of low (bottom quartile) socio-economic status. Moreover, socio-economic status heavily influences graduation from college, even among students from the top intelligence quartile; over 70 percent of high socio-economic status students graduate as contrasted to less than 40 percent for students from the low socio-economic quartile. This is not to say that financial factors are the only factors affecting decisions on college attendance, but they are surely important, and they can be most easily influenced by public policy.

Although low tuition permits some low income students to go to college, it often requires them to borrow heavily or to work more than is consistent with making good academic progress, in order to supplement the meager financial contribution received from their hard-pressed families. Existing student financial aid resources--especially outright grants--are grossly inadequate to fill the gap. Substantial numbers of higher income students, meanwhile, receive sizeable subsidies via low tuition even though they are, by objective tests, able to pay the full costs of their-education.<sup>4</sup> This is not to say that these students or their families are undeserving of aid for financing college expenses, particularly in light of the state taxes their families pay. The issue, however, is not one of determining who deserves assistance, but who needs it the most.

The basic problem, then, is how to use limited public revenue resources most fairly and most effectively. A low or zero tuition level for everyone implies a substantially increased level of state support. But if only a limited amount of tax revenue is available for higher education, which is more efficient? To use these funds to subsidize above-average income students who can afford to go on to college and would do so, we predict, even without the subsidy? Or to subsidize lower income students, many of whom who would otherwise not go to college at all, or who if they did go might have no alternative but to incur substantial debt?

Low tuition for everyone has another major drawback; it contributes to the making of socially undesirable choices by students as to the particular college or university they will attend. To the extent that public higher education is priced further below cost than is private higher education, an incentive exists for students to purchase more public and less private education. As a result, a student may decide to attend a college, to some extent because of its low tuition, even though he would actually prefer to attend another college which provides a type of education more suited to his objectives.

Low tuition is advocated by some because of the social benefits allegedly produced through higher education. Because society-at-large benefits, it is argued, society should provide financial support. But this argument is not persuasive. The nature and magnitude of the social, as distinct from private, benefits from undergraduate

education have never been carefully spelled out, let alone measured; thus, the belief in their significance is rooted in hope rather than in any firm evidence that they do indeed exist. Moreover, evidence exists showing that the financial return yielded to college students on the total public and private costs of college at least equals if not exceeds the return yielded from an equivalent expenditure on other investments;<sup>5</sup> this is aside from any consumer-type benefits produced by college attendance--the current and future satisfactions from learning. Accordingly, the incentives seem adequate without subsidies--at least for those not near the bottom of the ability-to-pay ladder. Thus, even if social benefits are large, no public subsidy is likely to be necessary to encourage the vast majority of higher income students to invest in college training. Again, we conclude that, as long as public funds for higher education are limited, spending them on across-the-board subsidies via low tuition is inefficient.

In short, a below-cost tuition policy, such as now exists in varying degrees at most institutions of higher education--though particularly at public institutions--does little to aid able, low-income youths in pursuing post-secondary education and training. At the same time it stands in the way of freedom of student choice among institutions. And by providing a misleading indication of the resource costs involved in undergraduate education, a low-tuition policy promotes a less efficient use of resources, largely through encouraging some weakly motivated young people from affluent families to go on to college only because it is an inexpensive thing to do.

Finally, the social benefits argument for public subsidies remains to be documented, but even if these social benefits exist, they do not imply public subsidization for everyone's higher education.

*THE HIGHER EDUCATION OPPORTUNITY PROGRAM*

Our proposal is designed to achieve both an equitable and efficient solution to the problems of financing undergraduate education. Although the proposal might ultimately be feasible at the national level, we view it as immediately applicable at the state level. Particularly with the possibilities of substantial federal support for higher education now appearing more remote, individual states must seek their own solutions to the vexing problems of financing higher education. This proposal and variations on it are now receiving active consideration by the Governor's Commission on Education, headed by William R. Kellett, in the state of Wisconsin.

The proposal, illustrated with data for Wisconsin, has three major elements:

- (1) The present financial system whereby the state appropriates funds for instructional and capital purposes directly to the public universities and branch campuses as well as to post-secondary vocational and technical schools would be abandoned, though only as far as undergraduate education is concerned. Instead, institutions would derive most of their operating income by raising undergraduate tuition to more closely approximate the full costs of instruction.
- (2) A standard student budget to reflect the costs of full-time college attendance would be determined. This budget would

recognize that elements other than tuition are included in a student's budget--especially maintenance expenses, and books and supplies. The tuition-cost component of this budget would be related to average full costs of providing public undergraduate education in the state.

- (3) The state would then provide supporting grants directly to students, based on the difference between the standard budget and their ability to pay. These grants would be based on financial need, using the need-analysis techniques now employed to distribute existing financial aid resources in Wisconsin and elsewhere throughout the nation.

The specific procedures for determining the size of the grant to each student would be as follows:

First, determine the "Standard Budget" for students attending post-secondary schools. Standard Budget--which is the same for all students--is defined as the sum of allowance for full instructional costs, books and supplies, and maintenance. The full instructional cost component reflects direct instructional costs (faculty and staff costs), indirect costs (libraries, administration, utilities, upkeep, and the like), and an allowance for the use of land, buildings, and equipment. Because these costs vary somewhat among the three public post-secondary educational systems in Wisconsin (University of Wisconsin, Wisconsin State Universities, and Vocational Technical Schools), we propose employing the average of costs at all public institutions in the state. The maintenance

allowance reflects the fact that by the time a young person reaches age 18 he is normally expected to make some contribution to his maintenance expenditures, even if he continues to live at home. This is particularly important for lower income families, for whom the prospect of having a son or daughter go to college implies a loss--or, at least, a substantial relative reduction--in potential total family income. In recognition of this fact, we have included in the Standard Budget of attending college (and, hence, of not working full time) a modest maintenance allowance.

Second, determine for each student-family unit its ability to meet the budgetary costs of attending college. This would be done with the now widely applied financial need analysis (such as that of the College Scholarship Service or American College Testing Service) which takes into account student savings and expected summer earnings, as well as for the previous year, parental income, parental net worth, family size, and other special considerations (large medical expenses) that might affect a family's ability to pay in any given year. Direct grants to students from other sources, such as outside scholarships and direct federal grants (i.e., Economic Opportunity Grants), would be included with the student-family contribution in calculating the amount of the state grant. However, state and federal loan funds and earnings from part-time work under federal work-study programs would not be included as a component of ability to pay.

Third, determine the amount of the student's Educational Grant from the state by deducting from the Standard Budget the amount the student and his family are able to contribute. For those students able to pay the full Standard Cost, no grant would be given. Grants would be limited to regularly enrolled, full-time students.

Under this plan institutions would be free to set tuition above or below the amount of instructional costs included in the Standard Budget allowance. Such a decision, however, would have no effect on the size of the Educational Grants awarded to students enrolled in the particular institution (except insofar as it affects the average tuition at all public colleges and universities). Moreover, non-resident students would not qualify for these grants; they would continue to pay a level of tuition approximating the full cost of the education they receive. Finally, the proposed plan provides for no change in the existing mechanism at each college for determining standards of student admissions.

#### *THE REDISTRIBUTIVE IMPACT OF THE PROGRAM*

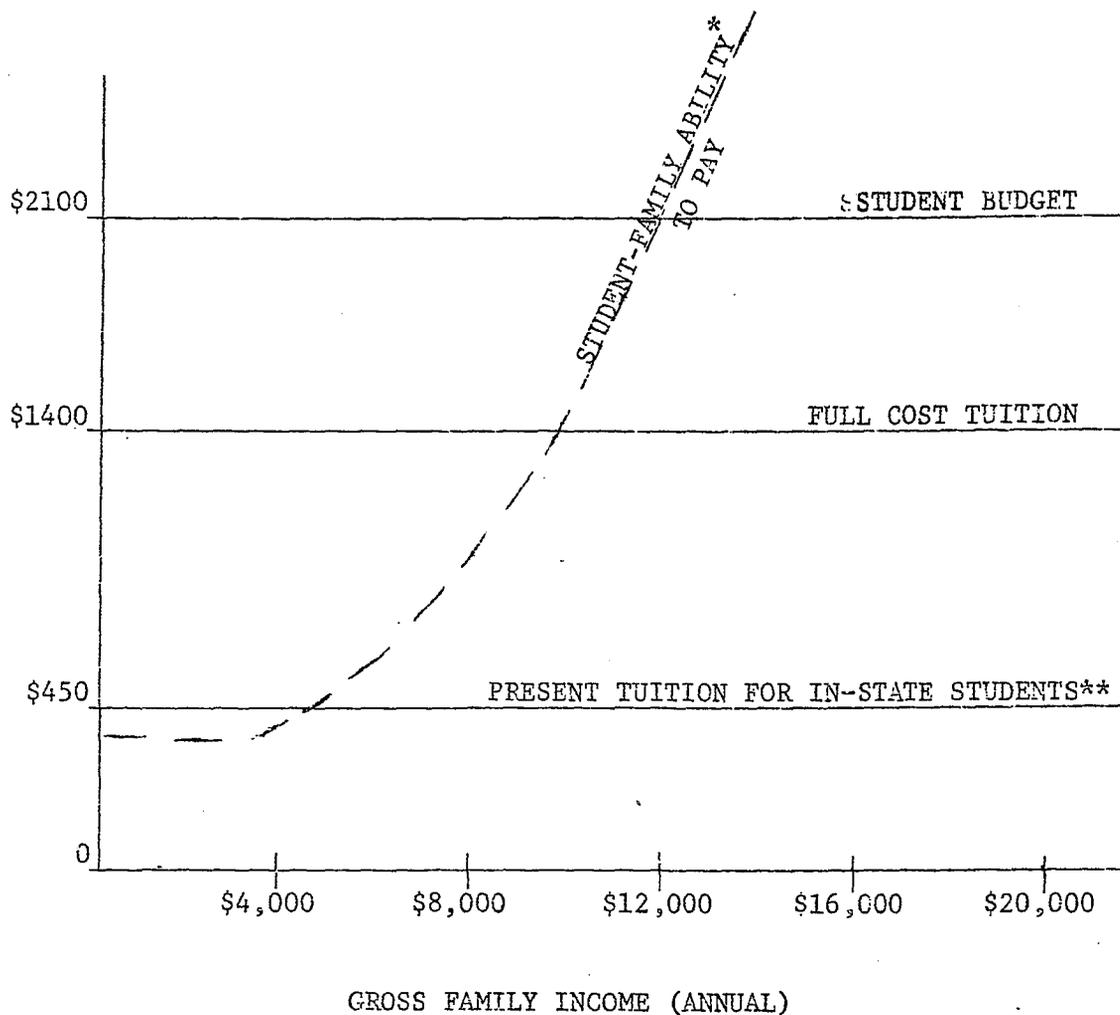
To show how the plan would work, let us focus on the redistributive effect of the Educational Grants. In 1969-70 the full costs of undergraduate education at public institutions averages \$1,400 per academic year per student, books and supplies average another \$100, and we set the maintenance allowance at \$600. Thus, the Standard Budget for attending college becomes \$2,100.

Utilizing data on the distribution of family incomes and related information (family assets, family size, students savings and student summer earnings) about students enrolled in the four existing systems of higher education in Wisconsin (private, University of Wisconsin, Wisconsin State Universities, and Vocational-Technical Colleges), we have employed the College Scholarship Service's new formula<sup>6</sup> to calculate ability-to-pay for each student. With the Standard-Budget figure and the ability-to-pay data, the size of the Educational Grants can be determined from Chart 1, as the difference between the Standard Budget and Student-Family Ability-to-pay. The redistributive effect--the extent to which students and their families are better off--can then be estimated.

For a family having an annual income of less than \$5,000 possessing no net worth, and having a total of three children, no family contribution to the education of the child is expected, according to the CSS formula. The student is, however, expected on average to contribute approximately \$350 to his own support through savings out of summer earnings. Thus, under our proposal, the student from such a low-income family would receive an Educational Grant in the amount of \$1,750 (\$2,100-\$350). Combined with his summer earnings contribution, this would bring him up to the Standard Budget total of \$2,100. He would be better off by \$800 as compared with his position under current conditions; he would pay about \$1,400 in tuition out of his \$1,750 grant, which would leave him \$350 in additional to the \$450 he now pays in tuition.<sup>7</sup>

For a student from a family having a \$20,000 annual income, average net worth, and a total of three children, a parental contribution of

RELATIONSHIP AMONG STUDENT-FAMILY ABILITY TO PAY,  
STANDARD STUDENT BUDGET, FULL INSTITUTIONAL COSTS,  
AND PRESENT TUITION. WISCONSIN 1969-70.



\*Based on two-parent, three-child family with average net worth, average student savings, and average expected contribution from summer earnings of \$350; College Scholarship Service.

\*\*Based on University of Wisconsin, tuition and fees for 1969-70; these are somewhat higher than the charges at Wisconsin State Universities and at Vocational Technical Colleges.

\$2,250 would be expected. In addition, the student would be expected to contribute from his own savings (on average this contribution would be \$150) and to earn \$350 in summer income. His total ability to pay of \$2,750 is, of course, well above the \$2,100 Standard Budget, thus making him ineligible to receive an Education Grant. He would be worse off by \$950, for his tuition has risen from \$450 to \$1,400. Put another way, this student's higher education would no longer be subsidized by state taxpayers.

The impact of the proposal in redistributing the costs of higher education among families is shown in Table 1 and Chart 2. Based on the 1969-70 enrollments of all Wisconsin-resident students in all post-secondary school systems, we see that the "breakeven point"--the income level at which an average family would be neither better nor worse off under the plan--lies in the \$7,500-9,999 family income class. Specifically, students from families with incomes below \$8,500 gain from the program, and those with higher incomes pay varying additional amounts ranging from about \$200 per year at the \$10,000 income level, upward to \$950 per year as the family income surpasses \$12,500. Overall, about 35 percent of the families would gain by the program, and 20 percent would neither gain nor lose by any significant amount, while 45 percent would pay between \$500 and \$950 more per year to educate their children. Though the size of the added payments is not trivial for a substantial part of the population, the incomes of these families are such that they are in a far better position to pay for the education of their children than are lower income parents.

The breakeven point can be shifted rather easily, if desired. If we added to the proposal a \$200 across-the-board grant to all students and their families, the breakeven point would shift from \$8,500 to approximately \$10,000; the average losses shown in Chart 2 would drop by \$200 and the gains would rise by \$200. This situation is depicted by the dashed line in Chart 2. Of course, any shift in the breakeven point through use of flat grants increases the cost of the grant program. An alternative is to increase the maintenance allowance, which while raising the cost of the program, continues to direct financial aid to students and their parents based upon need. The result of this approach is indicated by the dotted line in Chart 2.

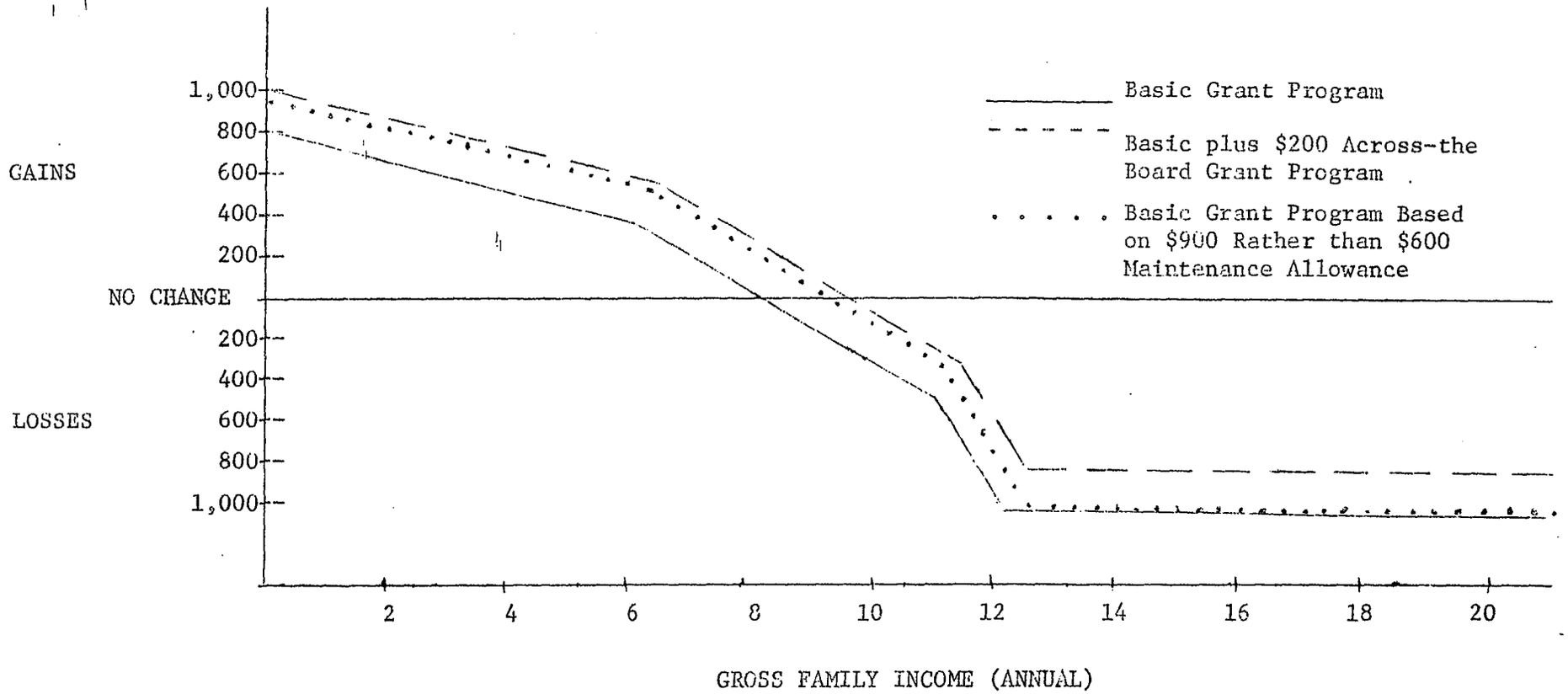
TABLE 1  
REDISTRIBUTION EFFECTS OF HIGHER EDUCATION  
OPPORTUNITY PROGRAM\*

<u>Family Income Level*</u>	<u>Percentage Distribution of Student-Families</u>	<u>Average Effect by Family Income Level</u>
0 - 4,999	16	+ 600
5,000 - 7,499	19	+ 400
7,500 - 9,999	20	- 50
10,000 - 12,499	13	- 500
12,500 and over	32	- 950

\*Based on gross family income before taxes.

CHART 2

GAINS AND LOSSES FROM HIGHER EDUCATION  
OPPORTUNITY PROGRAM, BY FAMILY INCOME LEVEL



Source: Based on Table 2.

*COST OF THE PROGRAM*

The cost of the program to the state can be roughly estimated. Two types of estimates are relevant: One is the total cost based upon current enrollments, and the other is the total cost which takes account of any enrollment increases produced by the program, particularly by the enrollment of able, lower income students. Finally, current state appropriations for undergraduate education can be determined from state budget data. All of these data appear in Table 2.

For Wisconsin the cost of Educational Grants in 1969-70 would total approximately \$85 million, assuming no enrollment increase. With an anticipated enrollment increase of between 3,000 and 6,000 students, and assuming that all of them would receive maximum grants, the added cost would run between \$5 and \$10 million. Hence, the total cost of implementing the program would range between \$90 and \$95 million.<sup>8</sup>

Since the state of Wisconsin now commits resources in the amount of \$123.3 million to support undergraduate education, adoption of this proposal would yield a savings of between \$28 and \$32 million. This substantial saving arises because the present large subsidies in Wisconsin are more than sufficient to offset the total estimated financial need of students.

These savings underestimate the expected savings to the extent that federal and some outside scholarships and grants continue. Direct federal grants alone amounted to over \$3.5 million for Wisconsin undergraduates in 1968-69. These sources of funds would, as noted earlier, be incorporated into the grant formula and thereby act to reduce state grants.

TABLE 2

ANNUAL STATE BUDGETARY COST OF HIGHER EDUCATION OPPORTUNITY PROGRAM  
FOR UNDERGRADUATE POST-SECONDARY EDUCATION  
(in millions of dollars)

<u>Costs and Savings to State Budget</u>	<u>Based on 1969-70 FTE Enrollments (1)</u>	<u>Based on Additional Enrollment** (2)</u>	<u>Total (1) &amp; (2) (3)</u>
1. Cost of grants to students who cannot afford to pay standard cost*	\$85	\$5.1 to 10.2	\$90.1 to 95.2
2. Savings in appropriations now made to support Post-secondary education			
- Institutional Subsidies (UW & WSU)	93.3	-	93.3
- State aids to Vocational Schools	8.8	-	8.8
- State Scholarships	6.2	-	6.2
- State Payments for Capital Amortization	15.0	-	15.0
	<u>\$123.3</u>	<u>-</u>	<u>\$123.3</u>
3. Net Cost (-) or Savings (+) to State	<u>+\$ 38.3</u>	<u>-\$5.1 to 10.2</u>	<u>+28.1 to 33.2</u>

\*Based on an estimated standard full cost of \$2,100 (\$1,400 full-cost tuition, \$100 books and supplies, and \$600 living allowance). It is assumed that the contribution rate of federal and local governments to the Vocational and Technical School System will continue at present levels; the continuance of these non-state instructional subsidies reduces the full-cost and hence the tuition paid by students attending Vocational and Technical Schools.

\*\*Based on the assumption that 3,000 to 6,000 additional lower income students will enroll after the plan goes into full operation, and that the maximum grant is paid to each student.

The net savings in taxes could be used in three ways. First, they might be used to reduce the level of state taxes. Second, they might provide a source of funding for other programs.<sup>9</sup> Or third, they might be used to provide additional grants to students and their families. For example, in addition to the grants outlined above, the savings in Wisconsin would permit a \$200 across-the-board grant to be made to every student, irrespective of his (and his family's) ability to pay; this is depicted by the dashed line in Chart 2. But such an additional grant would cost \$30 million per year to implement. It would, of course, give subsidies to many who do not need it by CSS standards. Alternatively, if the maintenance allowance were raised by approximately \$300, this would also exhaust the savings generated by the basic program; the result is depicted by the dotted line in Chart 2. Clearly, the redistributive effect would be greater under this alternative, since all grant money would be based on need.

#### *ON EXTERNAL SOCIAL BENEFITS*

One reason for giving across-the-board grants might be to take into account the benefits derived by society-in-general when undergraduate students receive post-secondary schooling. We stated earlier that such external social benefits, while frequently asserted to exist, have never been demonstrated to be substantial. Perhaps, however, they are, and in this event a case might be made for general financial support by taxpayers--at the state or even at the national level--rather than by students through tuition.

The basic formula for grants can be adapted easily to account for social benefits--assuming that they exist and whatever their amounts. If, for example, social benefits are determined to equal a particular percentage of the full instructional costs of college attendance--whether more than, less than, or equal to 100 percent of these costs--then that sum could be granted to every student--needy or not--while, in addition, every needy student received a grant equal to the difference between his ability to pay and the Standard Budget.

The size of the social benefits is seen by some as approximately equalling the full institutional costs of undergraduate education--this is the implicit assumption of zero-tuition advocates. But this line of reasoning raises several interesting questions: Is there any reason to believe that the value of these external benefits is such that to induce the optimal amount of college-going a subsidy must be offered, which exactly equals full institutional cost--no more or no less? Second, since the advocates of zero tuition retain that position through the years even though full costs are rising, this implies that external social benefits are rising by the same amount. Is there any reason to expect this to happen? Third, whatever the amount of social benefits, per student, are they produced in differential amounts by public and private institutions? (After all, few people if any are proposing complete subsidization of private colleges.) In light of these questions, clear need exists for a detailed examination of the social benefits of public undergraduate education.

It is, nevertheless, of interest to explore the cost implications of the zero tuition approach by itself and combined with the type of grant program proposed here. In Wisconsin, for example, a program of full tuition grants (zero tuition throughout the three public systems) to reflect the assumed social benefits would cost \$30 million more per year than is currently expended from state tax revenues; this would necessitate an increase in state appropriations for undergraduate education of approximately 25 percent. But giving larger subsidies to many non-needy would raise the cost of undergraduate education to the state without doing much either to stimulate additional college going among qualified lower-income youths or to reduce further the amount of debt incurred by those students. A combined program of zero tuition and grants based on ability to pay would cost about \$40 million more in state appropriations than is currently spent for undergraduate education. Whatever the rationale for subsidizing the non-needy--whether on the ground of external social benefits or on any other ground--the fact remains that the granting of such subsidies from a limited government budget conflicts with the objective of using that budget in the most efficient way.

#### *ADMINISTRATION OF THE PROGRAM*

This program would not require a radical new approach to the distribution of financial aid through Educational Grants. A structure already exists in Wisconsin, and in many other states, for administering student financial aid, i.e., grants, loans, and employment. In

Wisconsin the Higher Education Aids Board now administers close to \$40 million per year in such aid.<sup>10</sup> Moreover, two out of every three Wisconsin freshmen already submit a parents' confidential financial statement prior to enrollment. Thus, the proposed program would not necessitate the creation of a new apparatus but only an expansion of the existing system.

*GRADUATE AND PROFESSIONAL EDUCATION, RESEARCH, AND PUBLIC SERVICE*

The Higher Education Opportunity Program proposal, while providing for the financing of undergraduate education, says nothing about the financing of the other major programs of universities--graduate and professional education, research, and public service. Because all of these are vital to the mission of universities, adequate provisions for their financing is essential.

These functions would be financed in the same way that they are now financed, by general funding from the state, supplemented by whatever outside funds are available (federal research grants, private foundation grants, and the like). Requests for funding of these functions would be included as part of the composite higher education budget package. The package would include a request for funds to be used for direct Educational Grants to students, along with direct institutional support for these other functions. While this approach might further highlight the expenditures being made for other than undergraduate education, these expenditures can continue to be justified, as they are now, as constituting an integral part of the entire

higher education budget. Indeed, little needs to be added to what, has already been said by others about the close linkage among undergraduate teaching, graduate education, research, and public service.

It is also conceivable that some type of grant program for at least Wisconsin resident graduate students might be worked out, patterned along the lines of National Defense Education Act fellowships. Such a grant program should not be based upon ability-to-pay standards, inasmuch as graduate students have already attained adulthood and independence. Rather, the stress might be placed upon merit and achievement. Furthermore, such a grant program would have to be constrained to prevent the proliferation of graduate programs at institutions not properly staffed and equipped to mount effective post-baccalaureate programs. In short, some form of graduate student grants might well be worked out, though it is not an essential feature of the plan proposed here.

#### *BENEFICIAL EFFECTS OF THE PROGRAM*

We turn now to a more detailed consideration of effects the new plan might have on three parties: students and their parents, taxpayers and the (Wisconsin) state treasury, and colleges and universities in the state.

*Students and Their Parents.* For lower income undergraduate students this plan reduces the financial barriers to college attendance by providing state grants from which the students could finance much of their education. Higher income students and their families, by contrast,

will pay out of their incomes and assets the full costs of higher education. The combination of these two effects moves us closer to the desired equalization of opportunity, while keeping the aggregate costs to the state treasury within meaningful limits.

Turning next to the efficiency effects, we see that there will no longer be a purely financial advantage for students to select a public (previously low-tuition) school over a private (previously high-tuition) school, since the full cost pricing scheme works to eliminate much, though by no means all, of the present differences in tuition. There would remain, however, other positive reasons for attending a particular public college or university, including preference for its programs and location.

Some would argue that this plan encourages students to live at home; others, that it encourages students to live away. To some extent both are correct. Lower income students--even with the maintenance allowance--may be unable to supplement their resources sufficiently to permit them to live away from home. Some will find that the maintenance allowance is badly needed at home. For others, the maintenance allowance may be just sufficient to permit them to attend a college that is preferred but was previously too costly to attend when the added costs of living away from home were considered.

Meanwhile, some middle-income students will undoubtedly find that higher tuition costs reduce the financial resources available to pay the additional costs of living away from home. This is not necessarily bad. We must simply face the fact that it is very expensive to finance publicly the added expense of permitting all students to live away from home.

Others would argue that providing a maintenance allowance to students who actually continue to live at home is wasteful. In our opinion, however, the allowance, in addition to that part of the grant which defrays tuition, is necessary to induce a larger fraction of qualified young men and women from low-income families to attend college. Indeed, \$600 is but a small fraction of the \$3,000-\$5,000 of annual earnings which a young high-school graduate could expect to earn if he worked full-time rather than attended college. In low-income families the pressure on the high-school graduate to supplement family income is often powerful.

Another result of the proposal will be to change the mix of students in higher education. A larger number of students will come from lower income families. There may be some reduction in the number of higher income students attending college, in response to the tuition increase, but this is likely to most affect the less able and least motivated students. On balance, we would anticipate an increase in total enrollments.

With financial barriers diminished, somewhat more students will want to enter private schools. Whether private colleges and universities could or would wish to expand rapidly to handle the increased demand is questionable; it is notable, though, that their rate of expansion in response to the post-World War II G. I. Bill, and in response to the enormous growth in demand accompanying the post-war baby-boom of the 1960's were both quite modest. Thus, in part because private schools are not likely to expand rapidly, and in part because many students

will still prefer public colleges even if no tuition differential exists, we expect enrollments at public colleges to continue to increase under our proposal.

Finally, because students will now seem themselves more clearly as "paying customers" we expect them to be more interested in and concerned about the quality of education they receive. This should have a healthy influence on the academic environment.

*The State and Its Taxpayers.* Adoption of this proposal would have a dramatic impact on the relationship between higher education and the state. The legislature would no longer appropriate money for undergraduate programs at specific public colleges and universities. Instead, it would fix the level of grants to academically qualified, low- and middle-income students. This change breaks, or at least weakens, the direct link between the state legislature and the public systems of post-secondary schooling. It would in some ways lessen legislative power over particular institutions, it would also relieve the legislature of the burdensome tasks of scrutinizing, monitoring and passing on the undergraduate instructional budget for each public higher-education system.

The legislature would continue to play a role in shaping policy in higher education. A governing board--e.g., Regents--for each system would still be needed, and would continue to be appointed by the governor, so as to maintain the public colleges' and universities' leadership role in making higher education broadly available. The Standard Student Budget level would also have to be determined and

then approved by the legislature. Moreover, the legislature might still wish to provide special start-up funds to encourage certain new undergraduate programs or to continue separate funding for special undergraduate programs deemed to be of public interest. Of course, direct state funding for graduate programs, research, and public service programs (extension, etc.) at public universities would continue as it does now.

Under the program taxpayers would provide less support for higher education than they do now, although were the grant level raised, is conceivable that no change in total expenditures would result. Whatever the level of support, however, it is difficult to know whether taxpayers would be more willing than they are now to support higher education, given that grants would be going not to all students but to those with the greatest financial need. In any case, the large number of student-families receiving direct grants might well constitute a potent pressure group in support of higher education.

*Colleges and Universities.* Public colleges and universities would find themselves considerably less beholden to state legislatures for financial support. Indeed, they would be far better insulated from the political recriminations and periodic budget controversies that so often befall public institutions. Colleges and universities would also face increased competition with each other and with private schools for students and their tuition money. Tuition revenue would provide the principal wherewithal for mounting undergraduate programs,

just as now occurs in large degree at private institutions. This means that the distinction between public and private schools--already somewhat fuzzy--would be further blurred, though by no means eliminated.

A changed finance system for public institutions does not mean that public higher education, as we know it, will be destroyed or even hurt. We expect that initially little will change, but in time the incentives to offer more effective undergraduate programs within institutions should be enhanced. In addition, increased inter-school competition can be expected to raise the level of efficiency of departments offering undergraduate instruction. All in all, we see positive benefits accruing from the shift in the source of funding and the accompanying increase in competition and freedom of consumer choice.

*Possible Adverse Effects.* Even if we agree about the favorable effects of the proposed program of grants to students based on financial need, are there any unfavorable, unintended effects? If so, is there any way to cope with them?

*Students and Their Parents.* One class of such potentially adverse effects includes incentive effects--incentives to alter behavior so as to qualify for a larger grant. More specifically, there might be a greater incentive for college-age persons to become legally independent (emancipated) from their parents so that the parents' income and wealth would not enter the calculation of financial need?<sup>11</sup> At present, the handling of "emancipated" students is done on a case-by-case basis by individual financial aid officers; under the program proposed here, a uniform

procedure would have to be set up for treating such students. One approach to help get around this problem involves providing the Educational Grants to the parents for use by their offspring rather than to students directly.

A second adverse effect could operate to reduce the incentive for low- or middle-income parents to work, since the lower the parental income the larger the grant for which a college student is eligible. Existing welfare laws exemplify the potentially serious nature of such work-disincentive effects; if welfare payments are reduced by \$1 for every increase of \$1 in the family's income, then a person who considers working harder or longer faces an implicit income tax rate of 100 percent. Under the proposed higher education opportunity grant program, the implicit marginal tax rate for parents is far lower, beginning at 21 percent at \$6,000 of family income and rising to 30 percent beginning at the \$13,000 income level. What we call the implicit marginal tax rate is indicated by the slope of the "ability-to-pay" curve on Chart 1; this is equivalent to the rate at which "need"--and, hence, the size of grant--declines with income. Whereas a 21 to 30 percent tax rate should have a smaller work-disincentive effect than a 100 percent rate, we can only speculate as to the severity of even the 30 percent rate. Note, however, that these rates are well within the range of existing tax rates in the federal income tax.

In addition to the potential incentives to actually break up families and to actually work less and accumulate less wealth, there would be an incentive to appear to engage in these actions without

actually doing them. Thus, families would have an incentive to claim the independence of college students even while students continue to be supported by their parents. Or families might transfer title to assets to friends or relatives so as to be able to claim that they owned no assets. Or they might provide less than completely honest statements of their financial position.

Quite apart from incentive (inefficiency) effects, there are important equity questions: How should a young person be treated if his parents are unwilling to pay the sum that the financial-ability formula prescribes? What about an undergraduate student who is married--should parental ability-to-pay still matter? How should a young person be treated if he is over 21 and wishes to be financially independent of his parents? Or, what if he is under 21 and he becomes legally "emancipated?" The financial implications of the way that such questions are answered can be large indeed. At the same time, the methods of handling these issues under the existing financial framework affect in significant ways who goes to college and who receives financial aid.

All of these problems have been confronted in the connection with administration of welfare laws. Indeed, the proposed Higher-Education Opportunity Grants Program can be interpreted in part as a form of negative income tax program for parents of college students. But the fact that the problems are not new does not imply that the problems have been solved or that they are unimportant. The size of grants--a maximum of about \$1,750 per year for up to four years--is not so large as to cause enormous administrative problems, but neither is it trivial, especially for very low-income families.

*College and Universities.* Discussions with college and university administrators indicate some reservations about the program, and these seem to stem

largely from the uncertainty that the program creates for them and their institutions. Three questions recur in these discussions. First, how can administrators be certain that this program will not hurt their own institutions? Second, what will happen if the adverse effects of the program are such that the whole system of higher education is impaired? Third, given the fact that many nonfinancial factors, especially motivation, affect college-going how certain is it that significantly increased numbers of lower income young people will actually undertake post-secondary education? We attempt to deal with each of these questions below.

The main concern about the effect on the institution is that revenues will not maintain their current levels or will not grow at the anticipated rate. This would result either because of marked shifts in the distribution of students among schools or because full cost tuition would be insufficient to mount the desired level and quality of educational program.

To meet this objection, we offer several proposals. To protect against unforeseen revenue losses, the legislature might establish a special reserve fund from which allocations would be made over a period of four years, to systems (not individual institutions) if their revenues deviated by more than a stipulated percentage from their projected "normal growth." By normal growth we mean to revenues expected on the basis of current enrollment projections and adjusted for expected increases in the full cost of instruction, arising because of unavoidable cost increases (the need to pay competitive salaries, price level increases, etc.). Four years seems sufficiently long for all the transition adjustments to be worked out and the long-run suitability of the new financing approach to be determined.

The failure to spell out the mechanism by which the full cost of instruction would be determined has also created concern. Concern about this point is heightened by the existence of joint costs, and by the difficulty of accurately separating the costs of undergraduate instruction, graduate instruction, and research. Hence, there is fear that an excessively narrow definition of costs will impair the graduate and research programs. To cope with this, we suggest that institutional costs be established jointly by the systems of higher education (University of Wisconsin, Wisconsin State Universities, and Vocational-Technical Schools) in conjunction with the Wisconsin Department of Administration. Cost figures would be announced on January 1 of each year for the following academic year; these costs would be based on actual institutional costs for the previous academic year, averaged over the several public higher education systems, and adjusted upward to allow for price and other increases expected because of the two-year lag. The purpose of using the cost data for the previous two years as a base is that this permits an examination of the actual cost data rather than simply basing next year's costs on the previously projected cost data for this year. We would urge that special consideration be given to the existence of joint costs for institutions with multiple functions, particularly those involving both undergraduate and graduate education, not to mention research.

To help ease the uncertainty, and to help families adjust to what might otherwise be sizeable tuition increases during the first year of the program, we suggest that the program be phased in gradually over a

four-year period. Accordingly, the cost of instruction would not rise to the full cost level immediately but rather would increase by increments of approximately \$300 per year until full cost level is reached. By this plan the public higher education systems would each year become gradually more dependent upon student payments, while at the same time state support would shift gradually from the systems to individual students. The normal legislative-budgetary process would be employed, with the state appropriating its funds between system grants and students grants.

A key advantage of the four-year phasing in of the program is that experience can be gained with the program and modification made if difficulties develop. However, should the program be found to be unworkable or have strong negative effects, then at any time during the four-year period it will be possible to shift back to the system now employed. Although there is no reason to expect that such will be the case, it seems clear that the phase-in approach would facilitate implementation of the program and permit needed modifications based upon the experience gained with it.

Because motivation and family background play an important role in affecting the college-going aspirations of young people, some people believe that the importance of financial barriers may be overestimated. On the other hand, since it is difficult, to say the least, to affect motivation and family background, the primary variable on which public policy can work is the financial costs. In any event, it seems important to begin making young people aware of the possibilities of attending

college, and one way to do this is to publicize the availability of Educational Grants and to do this in the early years of high school. Particularly for lower income students, their motivation for going to college can be enhanced by the knowledge that financial barriers are not insuperable. As it is now, sizeable numbers of able students from lower income families may recognize the financial barriers to college early in high school and hence adjust downward their post-secondary educational aspirations. For more affluent students, similar counseling will be helpful in causing them and their parents to appreciate the costs of attending college and to begin making provision for its financing. In short, an expanded information and counseling program is a necessary and useful ingredient in insuring the success of this program.

One additional point needs to be made explicit. The Higher Education Opportunity Program is not designed to supplant many other existing forms of financial aid to students. Students will still be eligible for state and federal loan funds, given the eligibility standards which hold for those programs; in addition, federal work-study funds will continue to be available to eligible students upon application. These sources of funds must continue to be available, to allow for the fact that actual student costs for higher education will exceed the Standard Budget figure; moreover, unexpected changes in family circumstances may necessitate the borrowing of funds on the part of some students.<sup>12</sup> The only important change would be that students eligible for federal Educational Opportunity Grants would

receive state grants only if the federal grants fell short of the state grants; students would not normally be eligible for funding from both sources. The intent of this provision is to make use of whatever federal funding maybe available to support students, with state funds to serve as a backup where necessary. Finally, each public higher education system and indeed each campus would still be involved in assisting students with financial aid applications and with allocating those any financial aid funds administered directly by each system and each institution.

#### *CONCLUSION*

This paper sets forth a new proposal for financing higher education and explores some of its financial and other implications for Wisconsin. No effort has been made to compare this proposal with the various alternatives that have been proposed. In setting forth this proposal, however, we have necessarily compared it to the present system of financing higher education. Weighing all side of the issue, we are convinced that the Higher Education Opportunity Program merits the most serious discussion and consideration by state legislators and educators alike.

## FOOTNOTES

<sup>1</sup>For further details on these and other proposals, see Carnegie Commission on Higher Education, *Quality and Equality: New Levels of Federal Responsibility for Higher Education*, December 1968; and U.S. Department of Health, Education, and Welfare, *Toward a Long-Range Plan for Federal Financial Support for Higher Education: A Report to the President*, January 1969; and especially Ronald A. Wolk, *Alternative Methods of Federal Funding for Higher Education* (Berkeley: Carnegie Commission, 1968). For a broader survey of the issues, see joint Economic Committee, *The Economics and Financing of Higher Education in the United States* (Washington: U.S. Government Printing Office, 1969).

<sup>2</sup>U.S. Department of Health, Education, and Welfare, *Toward a Long-Range Plan for Federal Financial Support for Higher Education: A Report to the President*, January 1969, p. 5.

<sup>3</sup>William H. Sewell and Vimal P. Shah, "Socioeconomic Status, Intelligence, and the Attainment of Higher Education," *Sociology of Education*, Vol. 40 (Winter 1967), pp. 1-23, and especially Table 2, p. 11 and Table 5, p. 21.

<sup>4</sup>For a fuller discussion of the distribution of subsidies, see W. Lee Hansen and Burton A. Weisbrod, *The Benefits, Costs, and Finance of Public Higher Education* (Chicago: Markham Publishing Co., 1969) especially Chapter 4; and W. Lee Hansen, "Income Redistribution Effects of Higher Education," forthcoming in *American Economic Review, Papers and Proceedings*, May 1970.

<sup>5</sup>See Gary S. Becker, *Human Capital* (New York: National Bureau of Economic Research, 1964).

<sup>6</sup>Based on the newly adopted schedule of contributions; see *The Chronicle of Higher Education*, vol. 8, no. 8, November 17, 1969, p. 7.

<sup>7</sup>The extent to which he would be better off would vary somewhat from system to system inasmuch as tuition now differs among the public systems: in addition some financial aid now goes to state students in private schools in the state to help offset the higher tuitions they pay.

<sup>8</sup>No estimate of the administrative costs of handling the grant program is included. But neither is there any allowance for resource savings that might be produced through the simplifications this plan would permit.

<sup>9</sup>If local financial support of Vocational-Technical schools, were to be discontinued, localities would benefit by about \$15 million, the amount of their current support through property taxes. The program saving to the state would in this case drop to between \$13 and \$17 million.

<sup>10</sup>About a third of this is in grants--the rest is loans and employment.

<sup>11</sup>This is precisely analogous to the problem faced by the AFDC (Aid for Dependent Children) program which implicitly encourages family break-ups, for in states without the UP (unemployed parent) amendment, the family cannot qualify for assistance if an able-bodied man is present.

<sup>12</sup>As a result of this program, we might expect college loans to be much more evenly distributed by family income level than is now the case. By contrast, a full cost tuition program supplemented by a loan program (subsidized or not) would result in a much heavier concentration of debt among students from lower income families. This is much like the result of our present program.