

Remarks by Cathy E. Minehan
New England Board of Higher Education
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Good morning. I'd like to thank Jack Hoy for inviting me to speak today, and I'd like to congratulate the New England Board of Higher Education on its anniversary. I must admit to being a relative newcomer to some of the issues facing higher education, so I've enjoyed boning up a bit for this talk. Also, I serve on one college and one university Board of Trustees, and I can assure you I am now a much more knowledgeable trustee than I was. I'm not sure this will be welcome to the two affected Presidents, but they will have to learn to live with it.

Higher education, as you all are aware, faces tough times. Costs and tuitions have been rising even as families are more financially stretched, and state and federal governments have cut subsidies. At the same time, since the late 1980s, New England has been wrestling with some very significant economic

challenges, as diverse industries restructure their operations and try to become more competitive.

These two challenges, in the region, are intertwined. The recession of 1990 and '91 hit New England especially hard, and state governments here went into fiscal shock. That provoked sharp cuts to higher education throughout New England. Public colleges, in particular, must now compete more directly with state hospitals, social services, and prisons for funding. Even the elite private colleges were disrupted, and many of them have been anxious about their future. Taxpayers face choices they were able to avoid during the boom years, such as how to get the most for their money, and how to strike the right balance between fiscal stability and farsighted investment.

By tradition, indeed by necessity, New England has always lived by its wits rather than by its location or natural resources. Perched here on scoured rock at the edge of the North Atlantic, we have a harsh climate, fish, and water power, but no wide expanse of agricultural land, or coal, or oil that have played such

important roles in other parts of the country. Instead, we native-born and transplanted Yankees have always put great stock in education. The Puritans established Harvard University in 1636, and half the towns in Massachusetts had schools by 1776. Our most important exports have traditionally been products using the region's highly educated work force -- from mercantile services in the 17th and 18th centuries, to innovative manufactures in the 19th century, to computer hardware and software, instruments, aircraft engines, insurance, and financial and educational services at present. New England's prospects rely significantly, and increasingly, on its ability to develop an educated work force.

The interdependence of the region's economic health and its educational base is only reinforced by the shape of the local recovery. New England has been on a slow, but solid, growth path since payroll employment bottomed out in December of 1991. In previous recoveries, we typically witnessed a cyclical upswing in manufacturing employment, accompanied by growth in other sectors. In the present case, however, job cuts at manufacturers

have continued, and the burden of job creation has fallen primarily on service and trade industries. The service sector is a hodgepodge category -- ranging from software to car repair, health care to restaurants. And many businesses straddle several activities and defy classification. No matter how finely one breaks down the categories, a clear source of growth has been hard to find.

One thing is clear, though: The industries growing here and the current recovery reflect New England's longstanding strengths, including a skilled work force. The region's prospects thus depend in many ways on our complex of roughly 250 colleges and universities. As a major industry, they provide jobs -- about 113,000 at last count in 1991. As cultural and intellectual institutions, they make the region an appealing place to live. Perhaps most important, they educate our young, and attract students and faculty worldwide because of the high quality of teaching and research. Students frequently stay on here to extend the region's extraordinary tradition of technical and financial

innovation. Many of New England's cutting-edge firms grew from ideas developed at local universities. And in a more service-based economy, the payoff for brainpower can only be greater.

We've seen this show up, over the past decade or so, in the growing premium to a college degree. Economists have pieced together an explanation that goes this way, in broad brush:

For the past thirty years, there's been a steady rotation of demand for labor, away from manual, less-skilled workers and toward college-trained workers. Prior to 1980, the growth of industries using large numbers of college-educated workers -- health care, education, legal services, and the like -- accounted for the bulk of the demand rotation. Since 1980, a shift in the methods of production grew more important. Firms in all parts of the economy switched to technologies that call for more educated workers, such as engineers, accountants, and MBAs. What also happened in the '80s was that the expanding demand for educated workers outstripped supply, pushing their wages higher.

The colleges have become, far more explicitly, a means for

investing in our future. Undergraduates have shifted to job-oriented curricula, such as engineering, business, and other professional programs. In addition, more students are investing in a post-graduate education -- in medical, legal, and doctoral degrees. The baby boom "uppies" -- urban professionals who are no longer so young -- were the first to do so in a big way. The baby bust generation has followed in their footsteps.

The upshot is that today's college-educated worker earns much more than his or her high-school educated neighbor. The college wage premium seems to apply no matter what type of firm you work for.

Clearly, more education, and a more vocational education, benefits the individual economically. There is also good evidence that higher levels of education benefit the larger society. Studies show that an educated person tends to be more law-abiding and financially independent. And the knowledge that students acquire in college can be expected to diffuse through society. College-educated managers and professionals, aided by the explosion in

information technologies and all it implies, augment the productivity of others, including less educated workers. And the government recoups many of its subsidy dollars through the income tax, which recaptures a substantial slice of the additional income that a college education creates.

Economists have estimated the effects of these so-called spillovers: For each additional year of schooling, they find a 3 percent increase in general productivity -- in economic gains captured by society as a whole and not by the educated workers themselves. These public benefits go a long way in justifying public expenditures on higher education. And these expenditures are large. To run public campuses and to subsidize tuitions, the states spend \$40 billion a year.

As the economic importance of college has grown, so has its price. The cost of professors, administrators, books, periodicals, and, increasingly, technology, has risen faster than median family incomes, and significantly faster than the earnings of low-income households. Colleges have been trying to reach out to students of

modest means, and until recently, subsidies from government grants and college financial aid programs helped hold down the price of tuition.

But now, the subsidizing governments, beset by shortages of cash and pressed by more urgent budgetary needs, have cut back. In terms of state-level support for higher education, nowhere has the cutback been greater than here in New England.

On the federal level, New England's share of government expenditures for research and development has been shrinking. Other regions have expanded their academic R&D capabilities, and they have made stronger commitments to match federal R&D dollars with state funds. Federally funded science and technology projects are now more likely to locate in a state which is willing to pony up substantial matching funds. While this trend mainly affects a handful of major research universities in New England, these are the schools that consistently spin off marketable ideas and technologies to generate well-paying jobs.

Colleges and universities have far less financial room to

maneuver than they used to. They have responded in several ways: deferring maintenance, cancelling purchases, cutting programs, and some have even frozen salaries. But cost-cutting and retrenchment may not be sufficient. Some institutions may have to close or merge. Sacred cows like tenure need to be addressed. I know I reveal my trustee's stripes when I talk about cost-cutting, but I do believe that innovative management techniques, including the use of technology, can be important to higher education in reducing overhead and improving service quality to students. For schools with business departments this could be a case of "physician, heal thyself."

Some colleges have also embarked on the kind of restructuring that has swept through corporate America. As the Boston Fed's *Regional Review* magazine recently documented, forward-thinking administrators have been trying to carve out their own niches in the education market. The elite private schools developed "luxury" education, gambling that they could keep attracting students at higher prices, if families believed they were

copying the issue containing that article as well as others on education are available at the back of the room.

buying a superior product. Many public campuses, on the other hand, opened their doors to anyone with a high-school diploma. That's why the biggest gain in enrollment over the '80s came at public four-year colleges. A third tack, taken primarily by the less prestigious private colleges, was to further focus on practical, vocational programs. These schools emphasize applied research, and try to respond quickly to the changing skill requirements of local employers.

All institutions are also trying to extract more cash from the students and their families. Tuition and fees have grown as a percentage of budgets, while financial aid has fallen. Because of the depth of the regional recession and New England's high costs, some of our public systems are among the highest-priced in the nation. Higher education may not be overpriced, but colleges are having a difficult time convincing people that it's affordable.

As the economic burden has shifted to families, the students themselves have turned to increased work and debt. This is reasonable, given the investment value of a college education.

New federal guidelines to allow students to stretch their payments over a longer period, which would lower the monthly burden. And more generous and flexible terms could raise student loan limits. But pushed too far, forcing a student to work might jeopardize the students' educational experience. Jobs can absorb too much time and attention. And carrying debt is risky. Students can't know if their own future incomes will allow them to repay loans. The pressure of impending loan repayments may foster a strict vocationalism that might not benefit society in the long run.

Parents, the first source of funds, will probably also be called upon to increase their contribution. Among all the transfers of wealth they make to their children, the one with the greatest economic importance now takes place when they pay for their kids to go to college. The more the parents give, the more "human capital" the kids can acquire, and the further they go in life.

This transfer of wealth, however, occurs at a difficult period. The parents tend to be middle-aged, a time when their financial position is still in flux. Shocks to the household's income or

investment position can throw their financial plans into turmoil. If one parent gets laid off, or has to support an elderly or sick parent, the household's plans for sending the kids to college suddenly goes awry. Such risks, and not just the public benefits of education, provide another justification for government subsidy to education. Financing college is very risky for the individual family. Pooling the risk, through financial aid and subsidized loans, makes all families better off. More are willing to enter the game because they are confident that it can be budgeted.

Given the tightening of government subsidies, how can we more effectively manage resources to both ensure broad access and to impose cost discipline? I'd like to suggest three areas for attention.

First is the need for greater efficiency in the way public subsidies are used. All public expenditures should generate a public benefit. One of the best known government programs, the GI Bill, provided substantial financial support to all World War II veterans who enrolled in college. The GI Bill was quite successful

not only because those veterans excelled academically, but also because many of them would not have gone to college without the subsidy.

By contrast, evidence over the past 25 years has shown that many students at public institutions come from middle- and upper-income families and would probably go to college with little or no government subsidy. Expenditures on their behalf thus do nothing but limit the amounts available to the truly needy. Most education economists agree that subsidies should be directed to students who otherwise could not afford college. These experts advocate a means-tested subsidy, with a high-tuition / high financial aid program.

Second, we need to think hard about the extent of the government's role in the lending program. Where private markets cannot function well, and society would reap major benefits, government intervention is appropriate. Private markets traditionally have not supplied the students themselves with the necessary capital to underwrite an education. An 18-year-old

student is difficult to finance. There's no collateral, you can't repossess the asset, and you're uncertain of its value. These are big impediments. Private markets, do a trivial share of lending to students without a government guarantee, and even that share is projected to decline.

It now seems that the private sector's role may contract in the guaranteed-loan market as well. As many of you are aware, the federal direct-loan program, which took effect last year, places control of student-loan administration in the Education Department instead of with banks and other third parties. The exact level of savings this shift will yield over time may be debatable.

Proponents argue that the government will lend on a wholesale basis, at the schools, thus eliminating the middlemen -- the banks, the guarantee agencies, and the secondary market -- and the substantial fees each one charges. Direct lending will fund 5 percent of total federal student-loan volume this year, and is scheduled to rise to 40 percent of volume next year. Whether it is capped at 40 percent, or eventually expands to all federal lending,

has become a political issue in Congress.

Will the government allocate capital more effectively than the private sector? I'm not convinced of that. Banks, mortgage companies, and other private actors do a substantial amount of lending to the parents through such vehicles as home equity loans and second mortgages. Here, private lenders have a proven record of assessing risk and devising innovative ways to fill demand for capital. If private firms expanded their lending to students, without a government guarantee, they would have to charge a higher rate to offset their higher cost of capital. But the costs of a government program may escalate as well. Perhaps loans could flow mainly to the parents, who are creditworthy, rather than to the students. Would society then get enough investment in higher education? I don't know. An important factor may be the borrowing capacity of parents -- how many could afford to borrow an extra \$20,000 or \$50,000 or \$100,000. Until these issues are fully explored, I'm not ready to rule out the benefits of market discipline.

A third area in need of attention is the way parents make their financial contribution to the cost of college. I've been speaking of higher education as a capital expenditure, a good which yields benefits over time. This investment in human capital does generate a high rate of return. While we are used to thinking this way, parents and financial aid officers all too often do not. Many parents find themselves facing costs of up to \$25,000 a year, and they ask, "How can I afford \$25,000 out of an income of only \$50,000?"

The same family, without hesitation, can tell you how they can afford to buy a \$100,000 home on the same \$50,000 income. They pay for it out of past and future income. They save for a down payment, and borrow for 30 years, reducing the out of pocket cost to a monthly payment of about \$600.

You folks in the business of financing education have the opportunity to plug a big hole. The determination of how much parents contribute should emphasize long-term financial strength, and not, as it is often calculated, the parent's current income. One

year's income for one year's tuition bill is probably the most irrational of all possible ways of looking at financing. Many families do finance over longer periods, as I noted before, using home equity loans, or by tapping savings accumulated over time. But as I understand it, the conventional way of looking at the funding issue remains. That linkage of one year's tuition to one year's salary is the problem and we must break it to keep parents fully in the game. That means convincing them that the investment is worth it, and that being a capital investment, it can and should be financed over a longer period of time.

Finally, I believe that you in the financial and the higher education communities could provide families with better information and resources for financial planning. How much does someone really need to save for college 10 years down the road? Should they count on equity in a house, or a 401(k) plan at work? There are a lot of confused parents out there, probably making unwise choices on the basis of poor information.

Some institutions have recognized this problem and are

responding. Nellie Mae, based in Braintree, for example, has started to emphasize early awareness by publishing financial aid and loan brochures for high-school students and their parents. Other lenders and the colleges themselves would do well to reach parents even earlier, when their children are in elementary school.

The important questions involve tradeoffs between private markets and government intervention. The government's subsidies to higher education have yielded substantial benefits over the years. Now, individuals are being called on to step up and shoulder more of the responsibility. Private lenders should have the opportunity to finance these arrangements. But if the parents fail, there ought to be a safety net for the kids. You are the ones who can make sure the net is durable, and catches only those who would fall away without it. I hope this conference will generate good, practical ideas to make higher education more accessible, without sacrificing quality. For New England can't afford to waste the educational potential of any one of our citizens.