

THE FUTURE OF HIGHER EDUCATION: HIGHER EDUCATION AT A CROSSROAD
FEDERAL RESERVE BANK OF CHICAGO

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Welcoming Remarks

Good morning. It is my pleasure to welcome such a distinguished group of academic, business, and policy leaders to the Federal Reserve Bank of Chicago. Along with our cosponsors, the Committee on Institutional Cooperation of the Big 10 and the Midwestern Higher Education Compact, we are pleased to provide a forum where the future of higher education can be discussed. I also want to take this opportunity to thank our two cosponsors and in particular, Barbara McFadden Allen from the CIC and Larry Isaak from the Midwestern Compact, who have been instrumental in developing this outstanding agenda.

Let me begin by offering my perspective on the value of higher education to our economy. At various points in my life I have been a student, a university professor, a college trustee, and an employer who relies on highly educated workers to help run a complex organization. As both an employer and an economist, it is clear to me that the relationship between education, productivity, and economic growth has never been more closely linked. While states and regions once prospered based on an abundance of physical capital and natural resources, today the quality of a region's human capital is paramount. This feature is particularly true for regions such as the Midwest, where our economy continues to restructure from manufacturing to services and high technology industries. These growing industries increasingly require college graduates to successfully compete in a global economy. Even in today's manufacturing firms, higher level skills are required, which mandates that workers obtain an education beyond the high school level.

Despite this recognition, we are at an inflection point. Enrollment in college in the U.S. is at a record level and expected to climb, as students and their parents recognize the very high returns to education in salaries and employability. Based on student demand, it would appear that higher education and its product has never been healthier, or more accessible to those who want it. However, financial pressures on colleges have also mounted. For public institutions, state support has eroded. As state spending pressures continue to rise for elementary and secondary education, Medicaid, and prisons, less is available for higher education.

In response, universities today are increasingly forced to rely on their own resources to make budgets balance. But this can restrict access, because schools must often dip into endowments and resort to aggressive tuition hikes to close the gap. It's a Hobson's choice. If the school is concerned with maintaining academic quality, large tuition increases are often the best option, but in doing so access for students may be limited. If on the other hand the university limits tuition increases, it is often forced to economize and offer reduced services, which can jeopardize quality through large classes and the use of part-time faculty. Both choices are far from ideal. Universities have also tried to increase productivity and have experimented with new technologies such as distance learning in an effort to serve more students at a lower cost. Many of the expected savings, however, have proven elusive.

Universities are also facing demographic challenges and a shift in their customer base. Nationally, the number of high school graduates is expected to peak in 2008. As a result, growth in university enrollment will increasingly come from older students and students with diverse ethnic backgrounds. Many work and have families. While they recognize the need for higher education, they are not able to attend a full-time degree program or live on a resident campus. Yet this is the future workforce, and it will be to our benefit to insure that they have access to the best in higher education.

Here in the Midwest, I would respectfully argue that we have one of the finest higher education infrastructures in the nation. Our mix of public and private universities is the envy of the nation and has a long tradition of driving economic growth and opportunity. The question is whether we can adapt this infrastructure to meet these changing conditions. This demographic challenge will be felt acutely in this region, as growth in the college-bound high school population will slump and what growth that will occur will be concentrated in nontraditional college populations. Our universities will need to consider how to meet the needs of a different type of student population.

How can universities navigate these challenges and flourish? That question is at the heart of our discussion today. As several of today's presenters have observed, universities have been unable to maintain the implicit "social compact" that once defined the relationship between universities and the public. This compact was based on a belief that education was largely a public good and, as such, government support was warranted. This notion has eroded over time. Today, many argue that higher education is a private good whose benefits primarily accrue to the student who is able to use his or her higher education to achieve a more satisfying quality of life and often significantly higher wages. This more market-driven notion suggests that higher education is an investment in an individual's human capital that has limited public spillovers. Therefore, it should be primarily financed by the individual.

I believe for universities to flourish, they need to revisit this "social compact" and make a clearer case for the public good content of education. In order to do this, universities will need to be more transparent in their operations so that the public can have a better sense of what the value of the institution is to society.

Several of today's presenters have written eloquently on this point. They suggest that universities need to more tightly define their mission and be more explicit about how funding is used to meet the multiple missions of a university, including education, research, and public outreach. Polls indicate that the public primarily values universities as places of formal education and often does not understand the return to society generated from the use of public funds for university research. In sum, universities need to become better educators of the general public and marketers of their product if they hope to attract greater tax support.

Another aspect of transparency is allowing for an easier understanding of the finances of higher education. Higher education is far from a homogenous economic sector. The financial structure and missions of schools

vary significantly. The public flagship university and the local community college serve differing student populations and objectives. Private colleges and universities are significantly different than local state colleges. The advent of the private for-profit university is yet another change to our system of higher education. How does the business model of these for-profit institutions differ from the traditional university business model, and are these institutions better meeting the needs of certain populations of students?

This variety is a source of strength in that it can cater to the differing needs of students, but it is also a source of confusion for people attempting to make higher education policy. For example, I asked a researcher on my staff to evaluate whether trends in tuition are making college less accessible. This seems like a pretty straightforward question. However, his answer was something less than crystal clear. As he put it, college has never been more accessible today than ever before—and it's never been less accessible, either.

It is now more accessible if one considers record enrollment and that the costs of attending community college can be completely covered if a student is eligible for a full Pell grant. In fact, one study found that 30 percent of community colleges actually charge negative tuition if financial aid is taken into consideration. But figures from the College Board find that, while the sticker price of the average 4-year public college or university makes up only 5 to 6 percent of the income of a student from a high income family, the cost of the same education consumes a staggering 71 percent of the family income of a low-income student.

Are students from low-income backgrounds being priced out of education? You can only answer this question by knowing exactly how much aid is provided to a low-income student and whether a particular school has the resources to fully fund need-based aid. Depending on the answer to this question, college may or may not be affordable and accessible.

In addition, the return to a college degree must be considered. If higher education is truly an investment in human capital, shouldn't students view this as an investment at least as important as buying a car or a first house? Taking on debt for a benefit that will span over an individual's life doesn't seem to be a bad strategy. If someone is willing to borrow \$20,000 to buy a car, should it be unrealistic to encourage them to borrow at least as much to finance an education? Given that the most recent statistics suggest that college graduates earn over \$1 million more over their lifetimes than high school graduates, student debt should not necessarily be alarming.

Finally, if colleges and universities are going to redefine the social compact to restore public support, they will have to address graduation rates. There are many reasons why students don't complete their degrees, so it would be unrealistic to expect 100 percent graduation rates. Nationwide graduation rates, however, stand at 50 percent and it is not unheard of to find schools with graduation rates of 20 percent. Particularly for the nontraditional student population, universities need to devise strategies that will insure that these students get degrees. Public confidence in universities will be higher if graduation rates rise.

Clearly the area of higher education policy is not meant for the timid. The historic and increasing importance of higher education to our economic well being makes this a policy area where we must succeed. Right now, the U.S. has a university system that is the envy of the world, but the world is catching up. I hope today that we can begin a dialog that will help us all better understand the challenges facing universities and what strategies will help us maintain the vitality of this key sector. Thank you.