

# The Cost of College

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Saint Louis University  
St. Louis, MO

February 21, 2018

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President and Chief Executive Officer  
Federal Reserve Bank of Philadelphia



FEDERAL RESERVE BANK  
OF PHILADELPHIA

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The views expressed today are my own and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

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Good morning and thank you. It's a pleasure to be here.

I'm going to start today with the expected: an overview of the economy and where I see monetary policy headed. I'll then segue into perhaps the less expected — but nonetheless apropos — subject of the cost of college and how that relates to the American economy.

Before I start, I'll issue the standard Fed disclaimer that the views I express today are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.

### **The Economic Outlook**

With that out of the way, a brief overview of the economy, which is doing pretty well.

On the growth front, consumer spending remains the driving force as it has been for the past few years. I see that contributing to above-trend real GDP growth in 2018, which I forecast will be about 2.5 percent. After this year, I expect growth to move back down, hovering around the 2 percent mark for 2019, and then edging further south.

On the employment side of our mandate, things are also strong. The labor market continues to tighten, and I see the unemployment rate continuing to drop, reaching as low as 3.6 percent by mid-2019. After that, I expect it to rise back up a few tenths of a percentage point.

In other signs of labor market conditions, I expect job creation to remain strong in 2018. I should note that, as the market continues to tighten, we will eventually see job creation slow — ultimately, if trends remain as they are, we won't need much more than about 100,000 a month

to keep up with population growth. It's something to remember on the first Friday of the month when commentators call, say, 160,000 jobs disappointing. It's all a matter of context.

The inflation side of the Fed's mandate is not quite where we want it to be, with inflation continuing to run below our 2 percent target. I do, however, forecast that it will reach, or exceed, that benchmark by the end of 2019.

Based on the relatively strong economy, but the continued stubbornness of inflation, I've penciled in two hikes for 2018. I use pencil because the data can change, and sometimes they don't accurately point to future events. Like when they predict a Patriots' Super Bowl win. The Fed's mantra is data dependent, and for now, the data continue to tell me two is the likely appropriate path.

The other discussion about Fed policy is whether we will rethink our longer-run goals and monetary policy strategy, which I am open to. I'm not advocating for a change, and I don't have any particular favorite in the alternatives. If we do have that conversation, I would expect a full and healthy debate of all the alternatives and their pros and cons.

## **The Cost of College**

Now to shift gears a bit but only a bit. The headlines about the cost of college show it's obviously pertinent to the national economy. But it goes deeper than the headlines, and I find that the underlying, secular trends are more impactful. So I'd like to talk about the several ways college, and the cost of college, affect the overall economy.

I want to make it clear from the start that when we talk about the price of college, we are certainly talking about the cost to individuals, but we're also talking about the financial constraints on the colleges themselves. The instinct is often to blame the universities, but they, too, are facing financial strain that is unlikely to ease.

I should interject here that I can come at this issue from a number of angles, with experience as a professor, as a business school dean, as a university president, and as the parent of three millennial children, including one who's just finished grad school. Each of those gives me a different perspective. But I'm going to speak today from the viewpoint of a monetary policymaker, with all the detached practicality that entails.

First and foremost, it's important to be clear about the value of education itself. From pre-K to postgrad, the importance of education is almost impossible to overstate.

It is one of the constants of human history that, throughout cultures and epochs, the foundation of every society has rested on the education of its people. From a policy perspective, education is the heart that pumps the blood into every other organ in the economy. It trains our workforce, it emboldens our innovation, it sharpens our competitive edge.

I am a great proponent of education for education's sake, but I'm also a pragmatist in that much of the goal of postsecondary education is to prepare students for work. And we have a very different labor landscape today than when I was in college. We live in a world that is rapidly changing on both a demographic and technological level, and the old models aren't necessarily keeping up with the demand for change.

## **Secular Trends**

First, the demographics.

Labor force participation in the United States is significantly lower than a decade ago. This is largely due to demographic factors and, according to research by my staff, is likely to continue to decline. I know that millennials are tired of hearing that everything is their fault, tired of headlines saying they're buying too much avocado toast and not enough housing. So the younger of you in the audience will be delighted to hear that this one you can blame on the boomers. The boomers represent the largest generation in our history to head into retirement, and they're living longer as well. And while I'm delighted at the prospect of the extended cut of my own golden years, this will put a strain on the economy.

For one, it means more people living on fixed retirement incomes, more people depending on Medicare and Social Security, and more people whose medical and general care expenses will be higher than they are now. Much of that burden will fall on the generations behind them.

It also means experiencing the downside of a simple economic equation: Growth is, fundamentally, growth in the labor force plus growth in productivity. Without an increase in one of those variables, GDP is likely to suffer, and in recent years, productivity growth has proven to be stubbornly low as well. Simply put, we need more people.

And while the millennial generation is actually larger than the boomers, millennials are both not yet in their prime earning years and not large enough in number to increase labor-force growth sufficiently. Additionally, the birth drop-off in the mid-'90s means that colleges are likely facing fewer occupants of classroom seats in the foreseeable future. This is an issue because the cost of college is, of course, affected by the numbers of people actually *in* college.

I want to reiterate the caveat about the views I express as being my own, and I want to make it clear that I'm a monetary policymaker — I don't add my two cents to fiscal, foreign, domestic, or any other policy. But people coming off the sidelines, as well as into the country, add much needed numbers to our workforce. They're also a component of financial success for colleges and universities. Students coming from abroad are an important revenue stream for colleges and universities because they pay higher tuition fees and contribute substantially to business and STEM programs. If it becomes harder for them to come, or if increased competition from abroad gives them incentive to stay home or go elsewhere, institutions' bottom lines suffer and our economy overall misses out on U.S.-educated students in critical fields. This won't be remedied by simply filling the void with American students; there are entire programs that just don't have enough domestic candidates to survive.

Another aspect of the landscape that has changed significantly since my own college days is the way technology has affected all aspects of work. It's no longer uncommon for people to have several careers in their working lifetime, and constant retraining is essential in virtually every occupation. And I'm not just talking about, say, doctors keeping up with the latest surgical invention; I mean that being an auto mechanic today is as much about the computer as it is about the chassis.

So, on this vast, macro level, we have the two irresistible forces of demographics and technology affecting the very movable object of the American workforce.

### **Financial Pressures and Barriers to Entry**

But we also have myriad financial factors affecting the individuals who make up the nation's student body and our current and future workers, not to mention the pressures on higher

education institutions themselves. Those burdens may affect the decisions people make about whether and how to pursue postsecondary education.

Both the sticker price of tuition and the discounted rate have risen faster than incomes over the past 20 years.

At the same time, state funding for higher education institutions has been steadily diminishing. Demographics are bound to impact this issue even further as an increasing share of budgets on the local, state, and federal levels goes toward retirement benefits, pensions, and health care.

These factors contribute to the growing share of student loans, which now makes up the second-largest slice of the consumer debt pie, surpassed only by mortgages. While the issue of tuition prices and decreased funding have fueled the market for student loans, I worry that mounting numbers, combined with uncertainty about the future of repayment and forgiveness programs, may deter some lower- and moderate-income students from entering higher education.

And while the financial determinants have received a lot of attention, there are other, less tangible factors that either erect barriers to entering college or affect students' success once they've enrolled. There are more elements to the school experience than just tuition and books, and campuses around the country have done great work to address that fact. Whether it's navigating office hours or finding resources like free tutoring, programs that focus on underserved students have been important factors in their success. There's a good body of research to back that up, both qualitative and quantitative.<sup>1</sup> In fact, one of the Philadelphia Fed's research teams is currently working with Rutgers University–Camden to assess the outcomes in one of its financial aid programs — in this case, one that offers financial relief to students well into the middle-class cohort. Part of their goal is to clarify those additional support needs.

When I was at the University of Delaware, we had a program for students who were the first in their families to attend college. We had them arrive in June so they could spend a few months familiarizing themselves with experiences their families just couldn't give them firsthand advice on. Some of it was academic, but a lot of it was soft skills, and it worked. Those students had

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<sup>1</sup> James J. Heckman and Tim D. Kautz, "Hard Evidence on Soft Skills," National Bureau of Economic Research Working Paper 18121 (2012), <http://www.nber.org/papers/w18121.pdf>.

first-year GPAs equivalent to their classmates whose families had a history of college attendance.

Increased cost pressures on institutions may force them to cut or curtail those programs, which would be a great loss, and disproportionately affect lower- and middle-income students.

### **The Resonating Impact**

The overall issue of student debt is important because it doesn't just affect individuals; it resonates across generational lines in families and spreads into the wider economy.

Research shows that in the decade leading up to 2015, the number of adults over 60 who took on student debt quadrupled, with roughly three-quarters of that being assumed on behalf of children or grandchildren.<sup>2</sup> Given the same demographic shifts I mentioned earlier, that means debt is being held by a substantial number of people living on fixed incomes, while the extended duration of their lives leaves them more likely to encounter increased care costs, making default a real threat.

On the national level, research by the Philadelphia Fed's Consumer Finance Institute, along with others, shows that student debt is affecting both small business formation and homeownership rates.<sup>3, 4</sup>

Those obviously pose a risk far outside the confines of individual debt.

Financial uncertainty and cuts to programs that support underrepresented students could also exacerbate the achievement gap and increase income inequality. This isn't just a social issue; research shows that inequality exacts a financial cost to the country as a whole.<sup>5</sup> We are also

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<sup>2</sup> CFPB Warns Student Loan Servicing Problems Can Jeopardize Long-Term Financial Security for Older Borrowers (2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-warns-student-loan-servicing-problems-can-jeopardize-long-term-financial-security-older-borrowers/>.

<sup>3</sup> Brent Ambrose, Lawrence Cordell, and Shuwei Ma, "The Impact of Student Loan Debt on Small Business Formation," Federal Reserve Bank of Philadelphia Working Paper 15-26 (2015).

<sup>4</sup> Zachary Bleemer, Meta Brown, Donghoon Lee, Katherine Strair, and Wilbert van der Klaauw, "Echoes of Rising Tuition in Students' Borrowing, Educational Attainment, and Homeownership in Post-Recession America," Federal Reserve Bank of New York Staff Report 820 (2017).

<sup>5</sup> Era Dabla-Norris, Kalpana Kochhar, Nujin Suphaphiphet, Frantisek Ricka, and Evridiki Tsounta, *Causes and Consequences of Income Inequality: A Global Perspective*, International Monetary Fund (2015).

missing out on vast opportunities on a national scale if we're not tapping all our resources. It makes logical sense that if sharp minds are denied access to a good education, they won't reach their full potential. It's an old argument, but new research backs this theory up, investigating what the authors call our "lost Einsteins." The researchers looked into the backgrounds of patent holders in the United States and found some common themes: People who scored well on elementary math tests made up the majority, which wasn't a surprise. But they also came overwhelmingly from privileged backgrounds — low-income students who scored the highest on the tests weren't any more likely to hold a patent than wealthy kids with below-average math scores. There were similar results for women, minorities, and people who lived in the southeast portion of the country.<sup>6</sup> Women alone make up more than half the population; the simple numbers tell us we're missing out on a lot of potential and productivity in a majority of the population.

### **Rethinking Old Models**

As I said earlier, I come at this issue from a lot of different angles, and the one I've chosen — the view of a policy wonk — can get away with bringing the doom and gloom and then leaving the stage. But I've seen a lot of inventive thinking on campuses, both as a Fed president and in my former academic life, so I'm going to step into the territory of opining about solutions. Again, remember that disclaimer and send any angry emails directly to me ... Changing some of the conventional wisdom in higher education could help. It can't solve the entire problem but thinking about the way we deliver postsecondary education, and the business models of the institutions, can make a difference.

The first question for colleges is, are we making the best use of all our resources? There are ways to use assets outside the standard models. Language departments can partner with other schools with bigger budgets to provide career-based instruction, like nursing schools certifying health-care-oriented Spanish or business schools offering business Mandarin. This isn't a declared minor, it doesn't require tenured faculty, and much of it can be done with supplementary software and less time in the classroom. That might seem like common sense, especially to the

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<sup>6</sup> Alex Bell, Raj Chetty, Xavier Jaravel, Neviana Petkova, and John Van Reenen, "Who Becomes an Inventor in America? The Importance of Exposure to Innovation," Institute for Economic Policy Research Working Paper 17-041 (2017).



students here, but academia can be almost intractably rooted in orthodoxy, and moving beyond comfort zones — or thinking about education as a revenue stream — can make people uncomfortable. There is often a resistance to change, even when it's in the best economic interests of the institution. The call from many — and I count myself as one — is for more creative approaches to maximizing an institution's assets.

Some of the most innovative thinking I've seen lately has come out of community colleges. As I said earlier, education for its own sake is important, and so is the range of learning that comes with a four-year degree. But there are also gaps to be filled in a constantly evolving workforce and new careers and areas of research that schools can branch out into.

I was recently touring Atlantic City and the wider Atlantic County, which are part of my District. Like a lot of places, when one industry drives the economy, it can be hard to diversify. Atlantic County is trying to optimize its assets beyond gambling to bring more growth to the area. I always knew they had an airport out there, but I hadn't realized the size and scope of it, even though I'm a New Jersey native. It's a hub of FAA research labs, they train U.S. Marshals, and the Coast Guard and Air National Guard have facilities there. It's got a 10,000-foot-runway that was built so the space shuttle could land in case of emergency. As far as resources go, it's a pretty great asset. But it wasn't being used as well as it could have been. So the county talked to the airline industry, found out there's a massive shortage of mechanics and other aviation specialists, and are working in partnership with Atlantic Cape Community College to create an institute on-site.

Or take Philadelphia, where YouthBuild Philadelphia Charter School, which serves students who've previously dropped out of high school, has partnered with the local community college on training and apprenticeships.

Programs like these can help students avoid debt, funnel people into well-paying, understaffed occupations, and develop new revenue streams without disrupting four-year programs.

### **The Value of Skills-Based Learning**

They do something else important, which is that they stress the value of skills-based training and unconventional paths to education. Not everyone needs a four-year degree and not everyone

needs to go college right away. A singular university experience isn't right for everyone, and if we can shift the thinking on the different ways people engage in higher education, we can shift the thinking about the ways we provide it.

My staff has done research on what they call opportunity occupations, jobs that pay at or above the median wage without a traditional four-year degree. They don't just know what fields they're in; they know where they are geographically, which could make it easier to create a pipeline. These are good, solid careers that can support a middle-class life.

Apprenticeships can also be incredibly valuable, as can any "learn and earn" program. They are a path to a career, and people can save for school later on, go back for more training, or master a profession.

I'm not advocating that traditional four-year institutions change their models to practical training. I am saying that the pragmatic approaches these programs take to meeting the needs of business and industry, while simultaneously being creative in how they educate students, can help us rethink some of the old ways of doing business.

This is the most inventive, diverse economy on the planet, and our approach to education should be just as innovative. In the face of multiple forces applying financial pressure, it just makes sense to rethink some of the ways institutions operate.

## **Conclusion**

Education, at all levels, is fundamental to the success of the American economy and takes on even greater importance in the face of a declining labor force participation rate. We need every possible person playing an active part, and access to the right education is crucial to their — and our — success. If we can be creative about how we deliver all aspects of postsecondary education, we can increase institutions' finances and better serve all students by preparing them for work, adapting to their needs, and helping them reduce or avoid debt.