

**Date:** December 17, 2010

**Subject:** Book Summary: *Why Does College Cost So Much* by Robert Archibald and David Feldman

Two economists at the College of William and Mary have published a book called '[Why Does College Cost So Much?](#)' In a co-authored [op-ed](#) published by Inside Higher Ed, Robert Archibald and David Feldman explain that their book is an attempt to dispel common and politicized narratives that blame rising college costs on a particular set of actors (the government, the administration, the faculty, or even students and families) who have created institutional dysfunction that must be targeted for reform. Instead, they attempt to examine higher education in the context of the American economy with the basic assumption that economic forces reshaping other industries might also affect higher education. The authors focus particularly on the role of technology in reducing the costs of manufactured goods and agricultural products, but not services.

Furthermore, their analysis questions the widespread assumption that the current net cost of college constitutes an affordability crisis. They show that while college prices have often risen faster than inflation, overall economic growth means that the average household income can cover the increased cost of higher education while still having more income left over than in the past. Below is a summary of their key evidence and findings.

### *Taking the Larger View and Avoiding the 'Industry-Analyst' Trap*

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As mentioned above, this book is unique in that it does not seek to explain the economics of higher education by applying a magnifying glass to institutions themselves, a technique that is limited because it isolates universities from their larger context and is biased toward locating causes that are within the institution while ignoring outside influences. So, if inefficiency and dysfunction are not the primary culprits in what are undeniably rising college costs, what are?

The authors begin by analyzing real prices of different goods and services over time to see if higher education prices behave similarly or uniquely compared to other industries. They find the following facts:

- **The price behavior of higher education is more similar to service industries than goods-producing industries.**
- **Higher education prices behave similarly to other personal services offered by highly educated providers.** Notably, the cost curves for dentists, lawyers, and physicians essentially mirror higher education, indicating that some common causal factors might be at play.

### *An Industry Beset by Cost Disease*

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The facts above are consistent with the theory of 'cost disease' advanced decades ago by Baumol and Bowen<sup>1</sup>, which holds that service industry costs rise more rapidly than the cost of producing goods, leading to steady price increases that outpace inflation. **Unlike goods producers, service industries have few opportunities to increase productivity without decreasing quality.** In a classic example, one can easily see the quality trade-offs involved with attempts to increase productivity of a brass quintet by decreasing the number of musicians or speeding up the music.

Archibald and Feldman detail many factors contributing to cost disease in higher education, which they argue resembles an artisan industry given the highly skilled labor required to provide a quality education. They particularly emphasize technological advancement, which in service industries (unlike goods) enables tasks to be performed better and creates

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<sup>1</sup> See Baumol, William J. and William G. Bowen: *Performing Arts, The Economic Dilemma* (1966).

entirely new tasks, increasing quality without decreasing cost. For example, data show sharp increases over time in the equipment-to-buildings ratio for service intensive industries (e.g. computers, scientific research, and medical equipment). Many of these new technologies require highly skilled technicians to install, run, and maintain them, increasing the wage premium for college-educated, high skill workers, who comprise over 80 percent of higher education employees. In summary, the authors write:

*The weight of the evidence suggests to us that very specific changes or processes taking place solely within higher education do not explain much if any of the tendency for higher education prices to rise more rapidly than prices in general. **The critical factors are that higher education is a personal service, that it has not experienced much labor-saving productivity growth, and that the wages of the highly educated workers so important at colleges and universities have soared. These are economy-wide factors. They have little to do with any pathology in higher education.***

### *Disproving the Dysfunction Narrative*

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After arguing that higher education is likely beset by cost disease, the authors consider and present evidence to dismantle several popular theories to explain rising college costs, including:

- *Gold Plating*: the argument that prestige-games cause an arms race between competing institutions that drives up costs through fancier buildings and dorms, and other services.
- *The Faculty Lattice and the Administrative Ratchet*: the argument that faculty members have, over time, abdicated teaching and administrative duties in order to focus on research leading to an increase in the use of expensive administrators, and a large base of non-tenure-track instructors to teach courses.
- *The Revenue Theory of Cost*: the argument that institutions will spend every penny they raise, and so controlling revenue is the only way to constrain costs.

The authors argue that **if these higher-education-specific phenomena were the cause of price increases one would expect that higher education’s cost curve would not look like other similar industries (it does), and that the upward pressure on price would disproportionately affect competitive four-year research institutions (it does not).**

### *Opportunities for Productivity Gains in Higher Education*

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The authors assert that the pressures of cost disease will persist as long as higher education remains an artisan service requiring highly trained professionals to interact in person with students. As a result, Archibald and Feldman consider at length whether and how online education might enhance productivity. **While they think that better integrating technology with instruction will produce marginal gains, online education is unlikely to revolutionize the industry unless post-secondary teaching is totally redefined.** Even then, unintended consequences could include:

- Static course content in an ever-changing world
- A shrunken research enterprise
- Inability to recruit the brightest minds to work as online-only instructors
- Declining focus on teaching critical thinking skills as opposed to facts and figures

Without a magic bullet to cure cost disease, one has to expect that higher education will continue to experience higher cost increases than overall inflation. Consequently, existing public subsidies and/or what students pay to attend college should be expected to continue outpacing inflation. However, the authors claim that this is not a huge concern if the average American household budget increases enough to more than cover these increased costs. This point leads the authors to one of their most counterintuitive findings: there is currently no college cost affordability crisis in the US.

*How to Measure College Affordability*

If the purchasing price of a good or service increases more than overall income, it becomes less affordable. This can cause households to make tradeoffs because they can no longer purchase as much as they previously could with the same income. **The authors look at income data over time and determine that, while higher education prices have increased more rapidly than inflation, the increases in overall income driven by other productivity gains more than offsets the increased cost.**

They present the budget share of higher education for families in each income quartile over time<sup>2</sup>, as well as the amount of income ‘left over’ for other things once tuition and fees are paid. The data show that for virtually every type of family and every type of institution, the amount of income left over after paying for college was more in 2003-05 than it was in 1990-92.<sup>3</sup> Thus, while college costs have been rising faster than income, overall income has gone up by more than college costs, leaving the average family with more resources ‘left over’ than before.

Below are the affordability results presented for public four year institutions like the UW. A few points of note:

- For the poorest students, the negative budget share indicates that they, on average, receive financial aid in an amount greater than the tuition rate to help pay for other costs such as room and board.
- For other students, the budget share does increase with time, but so does the amount of income ‘left over’.

*Table 12.2: Public Four-Year Institutions, Affordability Results for Net Tuition and Fees (pg 194)*

	1990-92	2003-05	Change
<b>Household Budget Share devoted to Higher Education</b>			
20 <sup>th</sup> Percentile of Income	-.18%	-4.62%	-4.44%
40 <sup>th</sup> Percentile of Income	3.73%	4.65%	.93%
60 <sup>th</sup> Percentile of Income	3.49%	4.55%	1.06%
80 <sup>th</sup> Percentile of Income	2.76%	3.31%	.53%
<b>Household Income Left Over</b>			
20 <sup>th</sup> Percentile of Income	\$23,693	\$26,787	\$3,309
40 <sup>th</sup> Percentile of Income	\$39,543	\$42,745	\$3,201
60 <sup>th</sup> Percentile of Income	\$58,221	\$65,320	\$7,100
80 <sup>th</sup> Percentile of Income	\$85,712	\$100,122	\$14,410

<sup>2</sup> Based on net tuition and fees charged by sector of higher education.

<sup>3</sup> The only exception is the lowest income students attending private four-year colleges, and they theorize that this has to do with the increased use of merit-based as opposed to need-based financial aid at such institutions.

The authors recognize that these numbers are based on average family income and average net tuition and fees paid. No single family is average, and individual families with particular circumstances can face affordability barriers (e.g. a family's income goes down in a given year even though the average income went up, or a family experiences a much greater than average increase in a particular expense such as healthcare).

The authors also note the troubling consequences for increasing income inequality and the 'hollowing out' of the middle class in the US. While this economic trend is far larger than the higher education industry, it has important implications, not least of which is the heightened importance of student access to quality public higher education: the most effective tool for social mobility in the US.

### *Increasing Access without Implementing Price Controls*

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If the authors are correct and the rising costs of college do not constitute an affordability crisis, this has important implications for policies aimed at increasing access. By their logic, assumptions that policies targeting college prices will increase student access will not only lead to failed policies, but also create unintended consequences that threaten the quality of US higher education. As a result, the authors focus not on pricing, but on who should pay for the growing cost.

In developing their recommendations for changes to higher education funding policy, the authors turn their attention to financial aid, and the evolving relationship between institutions and states. They offer three main recommendations:

- **Increase flexibility for public institutions** to manage their own resources and operate outside of cumbersome state processes and requirements.
- **Provide citizens with direct tuition grants rather than providing general institutional subsidies** to state institutions (e.g. Colorado's current policy) to move institutions from state-supported to state-affiliated and thereby change the political nature of the relationship between the states and the institutions.
- **Create a universal, transparent federal funding program** that would provide the money necessary to complete a four year degree at a public institution for every American citizen. While costly, this type of program has been shown at the state level to be the most effective way to increase participation in higher education for all groups.

Early [evidence](#) from Colorado has not shown the policy of directly funding students via higher education vouchers to be effective, and given current public and political sentiment about taxation and government spending, the creation of a large federal entitlement program is unlikely to occur. However, policy proposals aside, this book provides an excellently written and researched analysis of higher education costs and pricing outside of the highly politicized rhetoric that ordinarily dominates debates on the topic, and proposes some big new ideas for industry-wide change.

Ultimately, these two economists have marshaled a great deal of evidence to make very convincing arguments about a higher education industry beset by cost disease in an overall economy where productivity gains in some industries have spurred overall economic and income growth, while creating spikes in prices for service industries that rely heavily on highly educated labor. **They make a compelling case that the crisis in higher education is not about affordability but rather concerns the questions of who attends (student access), who pays (the public or the student), and how to distribute costs fairly across the household income distribution.**

*For more information, please contact: Jessica Thompson at [jlthomp@uw.edu](mailto:jlthomp@uw.edu) or 202.624.1428*