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Effects of key state policies on private colleges and universities: sustaining private-sector capacity in the face of the higher education access challenge

Fred Thompson ^a, William Zumeta ^{b,*}

^a Atkinson Graduate School of Management, Willamette University, 315 Winter Street, S.E. Salem, OR 97301, USA

^b Evans School of Public Affairs and College of Education, University of Washington, Box 353055, Seattle, WA 98195, USA

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Abstract

The relationship between key state policy variables — (1) relative (private–public) tuition prices, (2) state student-aid funding, and (3) public institution density — and the competitive position of private colleges and universities is examined. Elite private schools are found to be nearly impervious to state policy. Large and moderately selective private institutions are adversely affected by public institution density and low public prices. Such prices divert students who would otherwise prefer these private institutions to similar public schools. State student aid funding most affects the enrollment market shares of the small, low-selectivity private colleges enrolling the greatest proportions of minority and modest-income students. The findings suggest state policies in this era of strong demand for higher education and constrained public sector capacity should use price signals (student aid and public institution pricing) to encourage students to consider seriously whether private higher education might serve their needs as well as or better than public institutions. © 2001 Elsevier Science Ltd. All rights reserved.

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1. Introduction

The conventional wisdom in economics is that the pattern of state support of higher education is often both inequitable and inefficient. W. Lee Hansen and Burton Weisbrod (Hansen & Weisbrod, 1969; Hansen, 1972; see also Baum & Sjogren, 1996) adumbrated the inequity argument. They argued that the beneficiaries of low public tuition prices will on average earn higher incomes than the taxpayers subsidizing their education; that the

majority of students attending low-tuition public institutions are from high-income families and would have gone to college anyway; and that direct subsidies are highest on a per-student basis at selective public colleges and universities enrolling the lowest percentages of students from low- and moderate-income families.¹

¹ Some scholars also argue that indirect subsidies in the form of tax expenditures — income and property tax exemptions — are perhaps even more inequitable, because they disproportionately benefit a tiny number of elite public and private institutions (Clotfelter 1992, 1996; Clotfelter & Rothschild, 1991). These tax expenditures could amount to more than US\$15 billion annually, although they are probably less than US\$10 billion.

* Corresponding author. Tel.: +1-206-543-0743; fax: +1-206-685-9044.

E-mail addresses: fthompso@willamette.edu (F. Thompson), zumeta@u.washington.edu (W. Zumeta).

The efficiency argument comes originally from Sam Peltzman (1973)² who argued that government subsidization of higher education by means of low tuition at public institutions could actually reduce total consumption of higher education services. The best evidence on this point is provided by Ganderton (1992) (see also Kroncke & Ressler, 1993). Ganderton found that students substitute substantially lower quality public colleges for the schools they would have chosen in the private sector, which tends to confirm Peltzman's speculations about the possible effect of in-kind subsidies on student demand. This finding was based on extensive individual and college data and "a switching regression model that corrected for the joint decisions to apply to college and to choose the public or private sector" (Ganderton, 1992, p. 269).

Regardless of the validity of this specific finding, it is reasonable to presume that in-kind subsidies lead some students to substitute public college or university attendance for a private college or university education they would have preferred had they faced the true (unsubsidized) costs of their decisions. Recognition of this logic led Blaydon (1978) to propose a federal-state student-aid program to increase interstate student-aid portability so that students' choices would be less distorted by state-imposed constraints on their access to subsidies. This proposal has been endorsed by the Education Commission of the States (1990), among others, but faces political obstacles.

Economists and policy analysts have generally endorsed more even-handed state policies toward public and private colleges and universities — either by treating private institutions more like public institutions or by treating public institutions more like those in the private sector (Hansen & Weisbrod, 1969; Hansen, 1972; Spence & Weathersby, 1981; Zumeta, 1996). This would mean gradually raising tuition prices at public institutions to approach those of their private counterparts, increasing portable³ student aid to help financially needy students bridge the remaining tuition-price gap, and, subject to a ceiling, replacing loans with grants for students from low- and moderate-income circumstances.

The evidence is that states with more even-handed policies — relatively high tuition at public institutions, greater reliance on need-based student aid, etc. — have higher rates of student participation and more graduates. And, they achieve these desirable outcomes at a lower cost to taxpayers than states giving more single-minded

support to public institutions (Porter, 1990; Zumeta 1992, 1996). Zumeta (1992, 1996) also observed that more even-handed state policies were associated with a strong private sector, whether measured in terms of market share or enrollment growth, or expenditures on state relations. What he could not determine was whether even-handed policies produced strong private institutions or a strong private sector led to more even-handed policies.

The direction of causation is important. If causation runs from private-sector strength to even-handed policies rather than vice versa, it is unlikely that increases in public sector tuition rates will result in commensurate, complementary increases in portable state aid in jurisdictions with weak private institutions. Instead, higher tuition would merely shift more of the burden of support for public higher education from taxpayers to students and their families. The predictable result of such a shift would be decreased access, especially for students from low- and moderate-income families. Indeed, several scholars have observed that access and choice have already been impaired by the failure of need-based aid programs, especially grants, to keep pace with real increases in tuition during the last two decades (Wetzel, O'Toole, & Peterson, 1998; McPherson & Schapiro, 1991a, 1991b; McPherson & Schapiro, 1997; Kane, 1994; Savoca, 1991). This seems to be especially true for students from low-income families (McPherson & Schapiro, 1991b). Blacks and low-income whites are more likely to delay college entry in high-tuition states (Kane, 1996) and minority access by some measures actually diminished during the late 1970s and the 1980s as real tuition climbed (Paul, 1990).

It has also been argued that higher tuition at public institutions, greater state reliance on need-based student aid, and reduced expansion of the public higher education sector would not, in fact, cause private colleges and universities to accommodate substantially larger numbers of students. This assertion rests on the presumption that private colleges and universities are part of a complex competitive ecology whose history has forced each school to position itself toward a unique market segment or niche — a strategy imposed by the need to overcome rugged competition from tax-supported institutions (Birnbaum, 1983; Zumeta, 1999a). Carried to its ultimate conclusion, this line of reasoning implies that only those institutions that have successfully differentiated their products from those of their public counterparts — so that each now exploits an inelastic residual demand schedule (see Appendix B) — have survived. In this view, more even-handed policies would merely rotate the survivors' demand schedules up and to the right. Consequently, instead of accommodating substantially more students, the privates would respond to higher tuition at public institutions and increased state student aid by raising their prices even faster than would other-

² The logic outlined in Peltzman's article presents a special case of the general problem of subsidies-in-kind outlined in Alchian and Allen's popular introductory economics text (1969, pp. 168–174).

³ That is, tenable at the college or university of the student's choice — either public or private.

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