

**KEY POINTS**

▶ The intent of the Ford Policy Forum has been to explore how economics can make individual colleges and universities and our overall higher education “system” more efficient.

▶ Economics has been the foundation of the Ford Policy Forum, yet its interdisciplinary approach reflects the chairs’ strong belief that successful policy implementation often demands a broader set of knowledge.

▶ Economic analysis could be used to help solve what is really a collective action problem, when each individual institution, in trying to maximize the quality of its class, bids down the price for top students regardless of the students’ families ability to pay. In terms of the application of anti-trust laws to college and universities, the government should be open to institutions cooperating on limiting their merit awards.

▶ The future of American public higher education is very much at risk, particularly as no new revenue streams are likely to emerge over the next decade or so. We have entered an extremely stressful period for public higher education, and must devote considerable energy to addressing the problems of the cost and financing of our public colleges and universities.



# How Economics Can Help Colleges be More Efficient

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For more than ten years, the Ford Policy Forum, an integral part of the Forum for the Future of Higher Education’s annual Aspen Symposium, has been chaired by Michael McPherson and Morty Schapiro, presidents of the Spencer Foundation and Northwestern University, respectively. Its intent has been to explore how economics can make individual colleges and universities and our overall higher education “system” more efficient. The chairs have taken a broad view of their mandate, as reflected in the wide range of topics explored—from the optimal role of athletics in college admissions, to moral and ethical constraints in the application of economic analysis, to developing reasonable measures of higher education outcomes. While not surprisingly many of the Ford panelists over the years have been trained in economics, quite a few others have had a very different disciplinary focus, including fields such as literature, philosophy, psychology and sociology. Thus while economics has been the foundation of the Ford Policy Forum, its interdisciplinary approach reflects the chairs’ strong belief that successful policy implementation often demands a broader set of knowledge.

**T**he Forum’s June 2010 Aspen Symposium marked the completion of the Ford Policy Forum, and to celebrate more than a decade of success, we decided that our final session would return to its roots in economics. The participants are not only economists though—they also wear the hats of college and university administrators. The idea is that a reasonable test of the usefulness to the academy of economic research is whether those same researchers apply their own findings and those

of their colleagues as they lead their institutions. If not, can we reasonably expect that anyone else will?

## Ford Policy Forum Panelists

Fortunately, it isn’t hard to identify economists who have a foot in both the scholarly and the administrative camps. We, the chairs, have been co-authors for decades, writing on topics such as access and affordability, economic and non-economic returns to higher education investments, the economics of tenure, and the efficiency and equity of selective admissions. Moreover,

McPherson was Dean of Faculty at Williams College and President of Macalester College. Schapiro was Dean of the College of Letters, Arts and Sciences at the University of Southern California, President of Williams College, and is currently President of Northwestern University.

The other two participants in the 2010 Ford Policy Forum, Dennis Ahlburg and David Breneman, have also published widely on educational and other topics. While much of Ahlburg's research has been in the fields of economic demography, development economics, and labor economics, he has published important papers on college enrollment, admission yields, and college completion as well. Breneman is one of the giants in this field, having written definitive books and articles on community colleges, liberal arts colleges, proprietary schools, financial aid, and much more. Ahlburg was Dean of the business school at the University of Colorado before moving to his present position as President of Trinity University. Breneman was President of Kalamazoo College and later Dean of the education school at the University of Virginia.

Together the four participants have published on just about every topic in the economics of higher education. They have been presidents of five colleges and universities, all private, and deans of four, two private and two public. Their administrative careers encompass work at four liberal arts colleges and four research universities. In other words, both their research and their administrative careers cover much of American higher education.

Schapiro acted as moderator of the panel, and McPherson, Ahlburg and Breneman as panelists. While it is impossible to give the full flavor of hours of discussion and debate, we attempt below to paraphrase some of what took place.

## Discussion

Mr. Schapiro: Let's begin with David. You have contributed as much to the economics of education literature as anybody I can think of. You have also held a range of administrative positions. I would love to hear some specific instances of successfully applying research in making your college or university more effective.

Mr. Breneman: The vast majority of economists working on higher education fundamentally are labor economists who work on the demand side, doing studies of the demand for higher education. There's a smaller subset of us who have worked on the "supply side," or the institutional side. I have always thought of myself in that domain. The example I'm going to use is actually one where the administrative job I held contributed to my research, rather than the reverse. I was president of Kalamazoo, a private liberal arts college

in Michigan, back in the early '80s, and I had written earlier than that about the demographic decline. People said to me, "You took a presidency in Michigan at the beginning of the decline in the college-going cohort? Don't you read your own writing?"

We struggled with the budgetary situation and one of the key items we had to budget was the amount of institutionally financed scholarship aid we would give out. And we were treating it, in the accounting framework, purely as an expense, picking a financial aid number sort of out of the air and asking the board to approve it. But two months later my admissions director would ask me if we really had to stick to that arbitrary number because if we do, we might come in, say, thirty students short of our enrollment target. Now I was smart enough to use my economics training and conclude that the marginal revenue of adding the extra students would exceed the marginal cost—that we could generate some net tuition revenue (the sticker price less institutional aid) that would exceed the additional amount we would have to spend on their education. So I would tell the admissions director to add the extra students. But shortly after that my business head would produce expenditure breakdowns showing that we in fact exceeded our aid target, implying that I had somehow misspent the budget. I would promise my board not to repeat my "mistake" but of course I would do the exact same thing the following year.

Focusing exclusively on the aid budget, independent of marginal revenues and marginal costs, is ridiculous. I knew I was doing the right thing, but I never quite understood the logic of it. This was a classic case where the accountants and the economists would sometimes cross swords. After I left that presidency, I thought long and hard about the subject and satisfied myself about the underlying economics behind the wrong headedness of focusing exclusively on a financial aid target. It was simply a case of pure price discrimination, working our way down the demand curve. The logic today seems so simple, but in the 1980s, people just weren't thinking clearly about this. Bill Bowen and I wrote an article about discounting, contrasting his experience as President of Princeton with its long line of highly talented full-pay students desperate to be admitted with mine at Kalamazoo. At Princeton, student aid was always an expense, but at most other schools struggling with their budgets, it is also a net revenue enhancer.

Mr. Schapiro: Great example. That article that you and Bill wrote changed the way we all think about financial aid. Dennis, you are up next.

Mr. Ahlburg: First of all, it is fun to be up here as a member of a panel at a session I have attended numerous times in

the past. On the other hand, I feel like a new character in a series that's been cancelled. In any case, my co-authors and I have been looking at educational problems that unfold over time, with data that do the same. Much research focuses on cross-sectional analysis, comparing one college to another, but my work has concentrated on how things change over time. We look, for example, at how individual expectations about financial aid affect the probability that someone will enroll in your college, along with the amount they actually were offered. It turns out that if you surprise somebody on the upside, giving them more aid than they expect, the impact of the price discount is considerable. But if you disappoint them, giving them less aid than they expected, the effect on enrollment is twice as large. So it is critical to provide applicants with a good idea of the financial aid they can expect to avoid disappointing them. Unfortunately, at Trinity they waited until I took over on January 1st to move on admissions and financial aid so that we were incredibly late in making admission offers, and even later in offering financial aid. The result was unfortunately something like a ten percent drop in entering students.

Mr. Schapiro: Thanks Dennis. I think it's a safe prediction that that will not happen again next year. Mike?

Mr. McPherson: I want to say a little more on the subject of student aid, which is where a lot of Morty's and my work has focused. We wrote *The Student Aid Game* a dozen or so years ago, helping to popularize the tools of enrollment management. How do you think about using student aid, not simply to maximize your tuition revenues by discounting to students who can't afford to pay, but also to try to optimize the various qualities of the class you are interested in by pricing at the margin—explaining why institutions would engage in merit aid, in athletic aid, in affirmative action aid, and other things of that kind. You could pretty neatly describe how an institution would solve that particular problem.

Now, I hardly would say that we gave birth to an industry, because that industry was already warming up. But, in fact, what has happened is that this whole idea of financial aid leveraging has spread tremendously in higher education. CFOs are way past the time when they thought that they had a limited financial aid budget, which was really charity, and their job was to limit how much got spent. It's now major strategic thinking for the institution. And there are lots of consulting firms that will take ideas that can be worked out in a few days, if you ask for the data, and turn them into long reports with a lot of econometric analysis and a very large bill.

But I feel very ambivalent about the result of this, because this is a case where maximizing the interests of individual institutions may act against the social interest. In other words, in many ways we'd be better off if the CFOs had stayed dumb. While this is an example of how applying economic analysis can undermine the public good, economics can be used instead to help solve what is really a collective action problem, that each individual institution trying to maximize the quality of its class, while competing with others, is going to bid down the price for those students, regardless of the students' families ability to pay. In terms of the application of antitrust laws to college and universities, the government should be open to institutions cooperating on limiting their merit awards. So this is an interesting case where I think economic reasoning actually has had a big effect, but I'm not sure whether it is positive or negative.

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Mr. Schapiro: I want to add an example of my own, especially given that James Shulman is in the audience. The research that culminated in *The Game of Life* had an extraordinary impact on how highly selective liberal arts colleges allocate spots based on athletic ability. The data shocked many a college president in terms of the degree to which admissions decisions were being made by coaches and as a result, those practices changed. Another example is how the research by Cappy Hill and Gordon Winston has led to changes in financial aid and admissions practices at the most selective private colleges and universities. Cappy, the President of Vassar College, had planned to be a member of this panel but had to miss this due to travel difficulties. Cappy and Gordon wrote a series of highly influential papers showing that the representation of students by family income is more skewed to the affluent than was previously thought to be the case. Once faced with these data, many of these colleges and universities changed their student outreach practices as well as their financial aid formulas.

Time to move on to a second question. There was a time in the not-so-distant past when the number of economists writing on the economics of higher education was quite

small. Fortunately, there are many more of us today. Even in top journals such as the *American Economic Review*, there are regularly articles on student demand, earnings, and the like. Are there still topics you wish were studied more? Let's start this time with Mike.

Mr. McPherson: I think there is a big void in our understanding (from economists and from other fields) of how resources can be used to increase learning. One of our earlier panelists pointed out how strange it is that you can spend several days at a higher education conference where the concept of instruction is never even discussed. These are not straightforward questions, but we should try to answer them. If you do this—e.g., limit class size, change graduation requirements, etc.—what happens? Universities experiment all the time. They just seldom look at the results. A department may change the entire way they teach something (intermediate micro economics for instance), everybody feels good about it for a few years, and then they say let's go back and do it way we did before. So I would really like to see good work in that area.

Mr. Schapiro: David, what do you think?

Mr. Breneman: I don't know if this is just economics, or whether it is a broader issue, but I'm currently deeply involved with my co-authors in trying to figure out the future of public higher education. I'm getting almost despondent about the situation we're finding ourselves in, and there is a lack of analysis suggesting ways we could move forward. Many of us have written in the past about how the bottom was falling out of higher education, and a lot of the advice that economists gave in those writings was about the need to cut and to retrench. As an administrator, I never paid much attention to that, to be honest, given that we are sort of put in a situation where you have to be a kind of cheerleader. And in the period when I was an administrator, we were still in a world where that could work. You could work your way through on the revenue side, rather than really obsessing on the cost side. But I don't see the revenue streams emerging over the next decade. I really think we're going to go through a very stressful period of time, and I wish we had a better sense of how we're going to solve this next set of problems in financing and underwriting public universities.

Mr. Schapiro: Dennis?

Mr. Ahlburg: I spent thirty years teaching at business schools, so my world view is probably a little different from most of yours. During my five years at Colorado I spent

much of my time trying to persuade non-economists that economics had something to contribute, and that a tax rate on the business school that would embarrass the most left-leaning Scandinavian was probably not in the long-term interests of the university. Year after year, we would graduate a new generation of really angry business students who, for their first two years, didn't see a class smaller than several hundred, while we were very good at holding down class size for some other disciplines. Is there any evidence that this way of allocating resources is justified in terms of educational outcomes? At many schools, administrators think of business schools as cash cows, as they tax and tax them to support other fields. The same might be true of law schools, among others. It would be nice to know if they are getting their numbers right. So optimal taxation and internal reallocation of resources is a worthy topic of inquiry.

Mr. Schapiro: All four of us are Ph.D. economists, and I don't think it is a coincidence that so many deans, provosts and presidents come from our disciplinary field. I worry that too many boards of trustees are looking for economists or maybe lawyers to be academic leaders. What about Ph.D.s in philosophy, art history, or literature? Do you share my worry that this fixation with economists is misplaced? Is there anything about the study of economics that produces good administrators? Dennis?

Mr. Ahlburg: Starting with the strengths, the concept of opportunity cost is fundamental but unfortunately a lot of our colleagues from other fields don't entirely comprehend it. Administrators should always remember that by doing one thing, they are sacrificing something else. There is no free lunch in academe or anywhere else. On the other hand, thinking about the liabilities of being an economist, some of us might be a little too sure that we have all the answers.

Mr. Schapiro: I know that one of the lessons you have gained from doing development economics is that an appreciation of history, psychology, sociology and religion makes our economic policies more likely to succeed. I suppose the same is true for running colleges and universities. David?

Mr. Breneman: In my first foray into this field as a researcher, in my dissertation at Berkeley in the late 1960s, I thought hard about incentives and what motivates behavior. There was a tendency at the time to think of what was happening at these institutions as being independent of specific objectives that were being acted out in a nonprofit setting.



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Economists typically look carefully at the incentive structure, and realize that when things go off the rails, there is often a problem with incentives. The limitation is that if you are a real, true, card-carrying economist, you might just be humorless. And if you're humorless – you don't want to be a college president.

Mr. Schapiro: Mike?

Mr. McPherson: I think an important weakness for economists at universities and colleges is that people assume you're a Philistine, that you really don't appreciate what these other academic areas are all about. You have to bend over backwards to show people that we don't reduce everything to dollars and to ratios. On the other hand, a subtle strength we have is that we can often speak the language of our board members who come from the investment world, whether or not we in fact know what they are talking about. They are more likely to respect your opinion and that is a significant advantage economists might have over administrators trained in other disciplines.

Mr. Schapiro: One more question for our panel. There is a great deal of discussion about whether or not colleges and universities have learned anything from the financial debacle and the ensuing Great Recession. Dennis, what did you learn that will lead you to run Trinity University differently than you otherwise would?

Mr. Ahlburg: We are actually in quite good shape at Trinity. We haven't had to cut anything, we've been able to give salary increases, and to hire quite aggressively. But it was a different story at Colorado. The tendency is to think that this is going to blow over. So rather than cut something out, it is better to trim a little bit here and a little bit there. There is a good article by a professor at Colorado who has studied twenty years of downsizing in the corporate sector. He finds no evidence to support the notion that downsizing leads to better economic performance. The sad lesson I think is that at publics, you have to make very tough choices and I am afraid that many public universities are getting things wrong in how they reduce expenditures. Learning from the business sector can be very valuable. Take the model for state higher education – California. They are having a terrible time trying to work their way through this and proportional cuts made by committees is a recipe for disaster.

Mr. Schapiro: Dave, if you were still dean at Virginia or president of Kalamazoo, what would you do differently in light of the devastating recession?

Mr. Breneman: Let me put the question differently: What do I think we all should have learned? I hope we learned about the hubris of our investment strategies and about the dangers of the illiquidity that too many places found

themselves in. I trust everybody will have learned that hard lesson. Beware illiquidity, excessive leverage, and the reality of positive correlations across asset classes. The last four recessions were generated primarily by monetary tightening and were relatively short. We've trained faculty to think we can get through this and return to business as usual. But this time it may really be different. Unfortunately, having cried wolf for four previous recessions, I worry about how we're going to convince people that this time it is another story.

Mr. Schapiro: Mike?

Mr. McPherson: For heavily endowed places, and this applies to a certain extent to foundations as well as to colleges and universities, I don't actually worry so much about the investment policy. They made unbelievably large amounts of money by investing in things that eventually fell in value. But they made a lot more than they eventually lost. I do on the other hand think that there needs to be a somewhat new approach to spending policies. Of course universities aren't completely autonomous in spending policy; Congress is as myopic as university leaders. But that doesn't change the fact that university leaders are pretty myopic. Bill Nordhaus, former Provost of Yale, once did a really interesting paper that argued that the riskiness of most universities' operations was considerably greater than they thought it was, and he supported that hypothesis with lots of time-series data. I think human beings tend to overweight recent experience in thinking about the future. Bill Massy has the line that the first principle of control theory is that "a trend that is unsustainable will end." I think we're actually in the throes of that in the other direction now, that some people feel like this is just going to keep going down and down forever, and the future is one of disaster. But we also have to recognize that sometimes things can be out of whack for a decade or so. I think some rule along the lines of, "You never increase or decrease your spending (I'm not talking about your endowment take rate) by more than a certain fraction every year," would keep institutions from being seduced by the sense that the reason we're making so much money is we're just so much smarter than people used to be. Even two or three years ago there was a lot of evidence that wasn't the case. So, while the heavily endowed colleges and universities are just a tiny fraction of American education, they play an outsized role and could use some fresh thinking about their spending policies.

Mr. Schapiro: Speaking of which, not long ago the two of us along with Sandy Baum wrote an op-ed on exactly that topic.

Mr. McPherson: I remember!

Mr. Schapiro: On that note, I want to conclude by

thanking the members of this great panel. I think this is a fitting conclusion to more than a decade of interesting, provocative and enjoyable discussions. To Joel Meyerson and Maureen Devlin, special thanks to the two of you for allowing us to be part of the Forum and for putting up with the Mike and Morty show for all these years. It has been a wonderful ride.

▶ **MICHAEL MCPHERSON** is president of the Spencer Foundation. Prior to that, he served as president of Macalester College from 1996 to 2003. Before joining Macalester, McPherson taught economics for 22 years at Williams College and served as chair of the economics department and dean of faculty there. He is co-author or editor of several books, including most recently *Crossing the Finish Line: Completing College at America's Public Universities* (2009) with William Bowen and Matthew Chingos, and *College Success: What it Means and How to Make it Happen* (2008) with Morty Schapiro. McPherson has co-chaired the Ford Policy Forum with Morty Schapiro since its inception in 2000. He can be reached at [pres@spencer.edu](mailto:pres@spencer.edu).

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