

Creating Choice in California Higher Education: A Proposed Voucher Program

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ABSTRACT

The state of California currently has a monopoly on the provision of higher education that is directly subsidized by state taxpayers. This proposal suggests that California abandon the *single provider* approach and offers a choice or voucher program as a substitute. The purpose of proposing such a dramatic change is not necessarily intended to bring about a shift in policy. The paper, instead, uses the voucher proposal as a vehicle to ask: what is the state's interest in supporting higher education with taxpayer dollars and how can it most efficiently pursue that interest?

TALKING ABOUT PUBLIC AND PRIVATE GOODS

From time to time, I pose the following question to undergraduates enrolled in public policy classes: is higher education public or private good? The question presents an interesting challenge, both in terms of their own understanding of the concepts and in classroom dynamics.

Typically, the first answer offered is that higher education is a public good, with benefits for all of society. With some prodding, we can usually unearth the argument that a community (or state) benefits from having an educated populace. Though they may begin with civic arguments, we pretty quickly arrive at variations on an economic theme:

- Businesses are attracted to states with better-educated workforces.
- Individuals with access to higher education have the potential to innovate and invent, leading to investment, new businesses, and economic growth.
- As education increases, so does income,¹ and higher incomes mean more consumption, all of which leads to more tax money flowing into state and local coffers.

The last argument, however, usually seems to strike a spark in the brains of one or two other students. Pretty soon, they begin to assert that higher education is a private good. They quickly point out that individuals with college degrees make more money than someone with just a high school education. How much more? The most common ballpark number that is offered up estimates that a bachelors degree is worth about \$1 million more in increased lifetime earnings relative to the individual who only finishes high school. My audience of students typically enjoy hearing such a factoid. I feel compelled to point out that they should not plan on anyone handing them the money in a sack just after they cross the stage and receive their diploma, however. In fact, I feel it is best to refrain from pointing out that related research shows that incomes vary significantly relative to their choice of major.²

Nevertheless, it makes for a great discussion. The question is, of course, a bit of a loaded one and frustrates the binary thinkers in the room. But, we usually manage to arrive at a place where they accept that higher education can be both a public and a private good. I have been fortunate enough to have this discussion with classes at both the University of California (Berkeley) and the University of San Francisco. The flow and tenor of the conversation, regardless of location, are remarkably similar and predictable. Where things get interesting is when we move on to the following question: if the state has an interest in supporting higher education, how should it distribute its subsidy and to whom?

¹ Some might argue that the curve begins to bend downward for those dogged enough to pursue a doctorate.

² Carnevale, Anthony et al, *What's it Worth? The Economic Value of Higher Education*, (Washington, D.C.: Georgetown Center for Higher Education and the Workforce) 2011.

Put another way, why does the state provide students with dramatically different levels of subsidies in their pursuit of a degree – the completion of which will likely confer significant private benefits?

A TALE OF THREE STUDENTS: SAME OUTCOME, DIFFERENT COSTS (TO THE STATE)

For the sake of discussion, let me construct three hypothetical college students, all of whom graduate with a major in economics. If we hold some variables constant across all three, it is not unreasonable to assume that all are equally likely to (a) make the same contribution to the public good of the state; and (b) realize the same amount of private benefit to themselves.³

Table 1: Three Hypothetical Economics Majors

| Student | School | 4-yr Grad Rate | 5-yr Grad Rate | 6-yr Grad Rate |
|---------|-----------------|----------------|----------------|----------------|
| Able | UC-Irvine | 51.4% | 76.5% | 79.6% |
| Baker | CSU- Long Beach | 9.7% | 32.8% | 46.8% |
| Charlie | Santa Clara U. | 78.6% | 83.4% | 84.2% |

Source: U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS) via the California PostSecondary Education Commission (CPEC).

All three of them will graduate in May/June, 2011, though given the different graduation rates, they spent varying lengths of time pursuing their degrees. Charlie finishes in 4 years, Able in 5 years, and Baker beats the odds, completing the B.A. in 6 years.

Combining the length of time it took to earn their degree with financial data from CPEC makes it possible to estimate the total investment the state has made supporting each of the three students.

Table 2: Calculating the Amount of State GF Subsidy

| Student | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 | Total Subsidy Received |
|---------|---------|---------|---------|---------|---------|---------|------------------------|
| Able | na | 14,387 | 14,719 | 10,591 | 11,139 | 12,389 | 63,225 |
| Baker | 7,818 | 8,073 | 8,344 | 6,030 | 6,551 | 7,570 | 44,386 |
| Charlie | na | na | 0 | 0 | 0 | 0 | 0 |

Source: CPEC

As noted above, the expected benefit to the state is roughly the same for all three graduates. The state's investment, however, varies considerably. Table 2 also raises some interesting questions about productivity. For example, if the student at CSULB could finish in five years, the state would save 18 percent (\$7,800) of the total investment; the UCI student finishing in 4.5 years reduces the cost to the state by 11 percent (\$7,700). And, the numbers in Table 2 do not even begin to take into consideration combining some study at a community college for a portion of the undergraduate experience, leading to an even more cost-effective way of producing a degree.

The relatively simple example of the three graduates, Able, Baker, and Charlie, illustrates the two biggest challenges facing public support for higher education in California:

- The subsidy that is provided for higher education is distributed in a manner that does not systematically garner the best return on the states investment.
- Modest gains in productivity could produce significant costs savings, also improving the net benefit to the state.

A small number of people are thinking about the latter issue. Even fewer engage the former. Both, however, raise critical questions about efficiency of California's higher education efforts.

INEFFICIENT SUBSIDIES FOR HIGHER EDUCATION IN CALIFORNIA.

For over five decades, California has pursued a single model in its support of higher education. The state has sought to keep tuition/fees as low as possible, using the level of tuition as a misguided proxy of access.

³ This latter assumption, of course, flies in the face of research that suggests some employers are willing to pay a premium for graduates from more "prestigious" schools. Despite that market distortion, it is not unreasonable to assume that similar individuals, with similar aptitudes and training, have the potential to realize similar wages in compensation for their labor.

This focus on tuition levels had led to a skewed set of incentives with regard to how the state's investment is being used. For example, even after a recent series of tuition hikes, the state's share of a UC student's education cost can be close to 50 percent. As noted above, over the course of a degree, that subsidy can total more than \$50,000, or more, depending upon whether the student moves toward completion in a timely manner. One problematic feature of the "low tuition" mentality is that the subsidy is available to any student, regardless of means. The high school graduate who comes from a household earning \$40,000/year is charged the same tuition as the student who comes from a family with income of \$400,000. The chief exception to this practice is in the CCC system, where Board of Governors (BoG) waivers can reduce fees to \$0 for lower-income students. Though California does provide some aid to students on the basis of need, that contribution is modest.

A second inefficiency created by keeping tuition artificially low is that this strategy is nearly limitless. The individual student faces a diminished incentive to finish a degree in any set period of time because he or she is not faced with paying the full cost the education. It has becoming almost an accepted practice that a BA at a state institution will take longer than 4 years. Perhaps even more problematic, the institutions have almost *no* incentive to see that students complete degrees in a timely manner. The demand for their services continues to outstrip the supply they can offer and the state provides them with resources regardless of how well they serve the needs of students.

"FIXING" THE PROBLEM

There are a several different policy paths that could be pursued in order to introduce more efficiency into the system. These could include:

- Increasing tuition across the board for all students and, in turn, allocating the additional revenue to financial aid as a means of providing a greater subsidy to economically disadvantaged students.
- Increasing funding for student services and advising as a way to increase the probability that students stay on track toward degree completion.
- Encouraging state universities to identify critical, high-demand courses where limited access slows progress toward degree completion and encourage departments to increase their offerings.

With regard to increasing student tuition/aid, there has been movement in that direction as a consequence of state budget cuts. Substantially subsidized tuition, however, remains available to high-income students.

Regarding policy changes designed to improve completion rates, if one assumes that there has been some effort on this issue, it appears to have had little effect. An alternate explanation is that neither the UCs nor the CSUs have attempted to improve productivity. What is clear is that the completion rate for the past few years has been essentially flat (Figures 1 and 2).

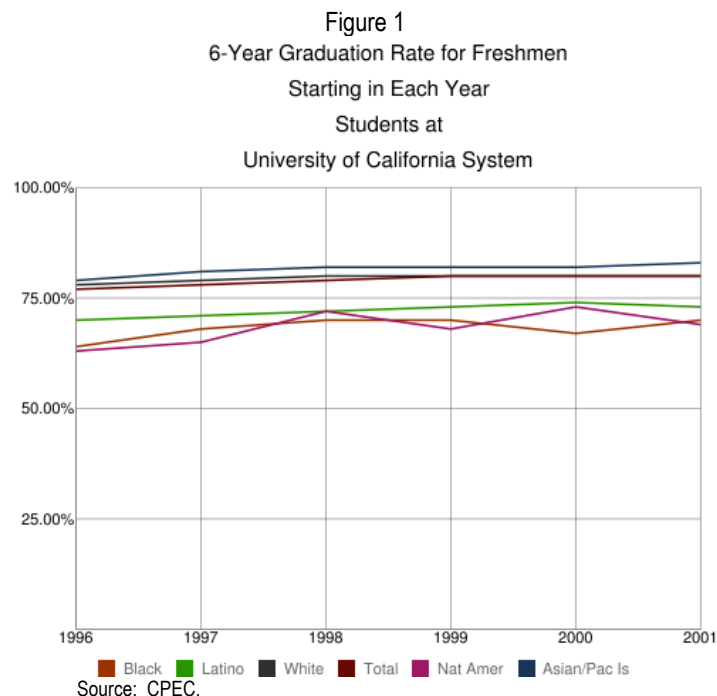
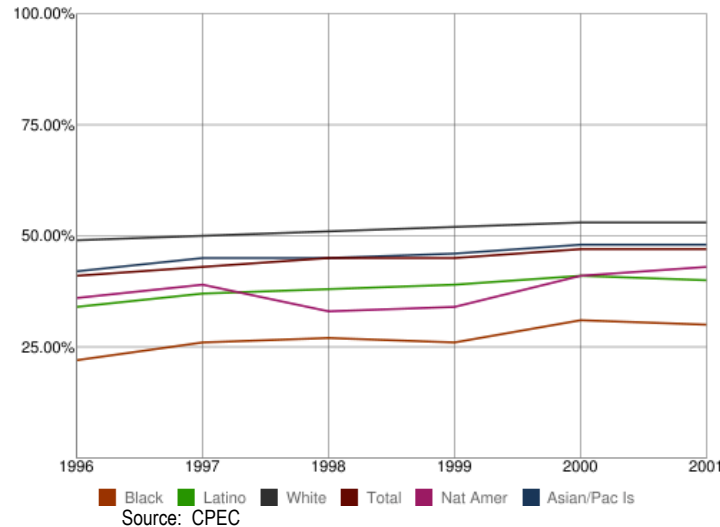


Figure 2
6-Year Graduation Rate for Freshmen
Starting in Each Year
Students at
California State University System



There also is, quite frankly, a surprisingly limited amount of leverage that can be asserted over the state institutions. Despite complaints of “micro-managing” by Sacramento, the UC and CSU systems are opaque enough that many directives can be half-heartedly implemented or ignored altogether. Also, given the relative diversity of institutions in the two systems, it is unlikely that a single set of prescriptive requirements originating in the state capital will effectively address the problem at all of the schools. In fact, it is conceivable that a directive approach could further skew incentives and actually decrease efficiency.

CHOICE, A NON-INCREMENTAL APPROACH

The above policy changes would be best described as an incremental approach to the problem. In most cases, they are relatively politically palatable. They present a threat to only a limited number of entrenched interests. And, the leverage points they access are recognizable to many. Unfortunately, they are unlikely to do much.

I propose a more radical set of policy changes designed to introduce a greater degree of efficiency into the provision of higher education by putting more decision-making power into the hands of the consumers of the service, the students. The chief components of such a change would be as follows:

- The UC and CSU system campus would be spun off as private, not-for-profit schools and no longer directly receive support from the state general fund.
- The state’s investment in higher education would be in the form of a subsidy to individual students (voucher).
- Vouchers could be used at certified higher education institutions in California.
- A higher education regulatory agency (HERA) would be created to certify institutions as eligible to receive voucher students.

Taken together, these changes would enable the state to target its higher-education investment to priority areas, and in a more equitable manner, while simultaneously restructuring the incentives for both individuals and institutions to improve productivity.

IMPLEMENTING A CHOICE PROGRAM

Though many would be tempted to compare the idea of a publicly supported choice program in higher education to K-12 reform efforts, the situations are quite different. First, higher education choice already exists and has for several decades. It is simply that the state has maintained a monopoly over most of the public subsidy provided to students. And, even in the halcyon early days of the Master Plan, there was a price tag on a 4-year degree. As a consequence, the consumers of higher education are well acquainted with the process of comparing institutions and making decisions based upon a number of different variables, including cost. If there is any doubt that choice is alive and well in higher education, would point to the significant industries that

exist both to assist students in learning about colleges and universities as well as a different group of consultants that helps colleges and universities market their programs to potential students.⁴ In other words, unlike K-12 choice programs where the market must be created and then a culture of choice has to be instilled among the participants, the higher education market already exists. It simply is a market that is dramatically distorted.

Liberating the UCs and CSUs. The first step is the most difficult and also the most critical. When one looks to privatize what had been traditionally public functions, there are a number of questions that should be asked to determine whether the activity is inherently a governmental one:

- Is there reason to believe that private entities will be unwilling to provide the service?
- Is the current activity an expression of state/sovereign authority?
- Is the nature of the activity one that necessitates a degree of “publicness” or transparency?
- Will government ownership produce a more equitable distribution of OR access to public resources?

The answer to all of these questions is no. Private education providers abound and there is nothing uniquely governmental about how a university functions. And, I would argue that the current policies of the CSUs and UCs are not necessarily any more equitable than many of the state’s private institutions.

As independent not-for-profit institutions then, the current public higher-education system would be free to do the following:

- Each school would be free to set its own tuition and fee structure and make its own decisions about financial aid.
- Each school would be free to establish its own admissions requirements.
- Each school would exercise discretion over how it distributes its resources.
- Each school would exercise discretion over how to structure its program offerings.
- Faculty and staff would no longer be state employees.
- Faculty and staff would be free to organize and bargain collectively, or not.
- Each school would establish its own policies regarding tenure, promotion, workloads, and the use of adjunct instructors.
- Each school would establish its own policies regarding faculty governance.

Though the change would be dramatic, it is far from impossible. In fact, it is arguable that the transition from public to private hands is far less complicated than, say, privatizing a state-run electrical monopoly, transit system, or mining interest. Finally, given the cohort nature of education, it would be natural to begin the transition one year at a time.

Empowering students to choose. The second step to establishing a choice system is to let the money follow the student. In the current higher education market, state institutions control both access to the service *and* access to the subsidy via the admissions process. A choice system would put access to the subsidy in the hands of the students, forcing the institutions to compete for those funds.

The voucher would be provided to students who met specific criteria regarding both academics and financial need. Families whose income and wealth exceed a particular threshold would not be eligible. A federal system already exists to determine how much a family can be asked to contribute to student’s education. That same process, with the parameters adjusted as necessary, could be used for to determine eligibility and the size of the vouchers,.

Each voucher would have a cap in both value and time. For example, a student who met eligibility criteria could receive a voucher that would be valued at a set amount, with an annual maximum draw down, and an expiration date.

Some back-of-the-envelope calculations suggest that such a system could serve a large number of students, provide a substantial degree of support, and introduce desirable incentives.

Table 3 combines the state’s current contribution to higher education from its general fund. Together, the CSU and UC investment totals \$5.6 billion and serves just under 600,000 full-time equivalent students.

⁴See, for example, Hoover and Supiano, “Marketing Consultants Offer Advice on Making the Most of the Recession,” *The Chronicle of Higher Education*, February 4, 2009.

Table 3: Funds potentially available for vouchers

| 2010-11 | Dollars (Thousands) | FTES | \$/FTES |
|-------------------|------------------------|----------------|---------------|
| UC | 2,911,638 | 235,009 | 12,389 |
| CSU | 2,682,709 | 354,382 | 7,570 |
| Total | <u>5,594,347</u> | <u>589,391</u> | 9,492 |
| Cal Grants* | 1,155,318 | | |
| Proposed Vouchers | 6,749,665 | 750,000 | 9,000 |

*State general fund and federal dollars.

Source: CPEC

Combining the more than \$1 billion in Cal Grant dollars produces a total pool of over \$6.7 billion. With those resources, the state could have provided an average higher-education subsidy of \$9,000/year to each of 750,000 college and university students (27 percent more students than currently attend UCs and CSUs combined).

Using the \$9,000 figure as an example, an eligible high school student graduating in 2011 would be offered a total subsidy of \$45,000. The student could draw down a maximum of \$10,000 in a given year, assuming he or she is attending school on a full-time basis. Part-time students can draw down up to \$5,000. The entire subsidy expires after eight years.

Should a student complete a bachelor's degree in less than five years, any unused draw down would become a bonus and could be used for either (a) paying off any accumulated student loans; or (b) paying for the first year of graduate study at a certified institution.

The absolute size of the voucher would vary based upon demonstrated financial need. The size of the voucher could also vary relative to identified state priorities, such as incentivizing students to pursue degrees in math, science, or nursing. Such incentives, however, would be tied to degree completion.

Regulating the higher education system. Students could choose to use their higher-education vouchers at any institution certified by the Higher Education Regulator Agency (HERA), a newly created regulatory body. HERA could be structured along lines similar to other service delivery regulators such as the CPUC, currently overseeing public utilities.

HERA's board and staff would establish the relevant institutional criteria required to be eligible to receive state vouchers. These rules would include reporting requirements, nondiscriminatory admissions and hiring practices, and minimal standards of service. HERA certification would also require schools to participate in a state-maintained data base that assigned students unique, individual identifiers. As noted above, the mix of services, costs, and other operating policy decisions would be left up to the institutions.

All four-year degree granting higher education institutions – for-profit and non-profit – would be eligible for HERA certification. All would have to meet academic quality standards (similar to existing regional accreditation requirements) as well as retention and completion benchmarks. A school that falls below the standards could first be put on probation and could eventually lose its certification. Uncertified schools, of course, would no longer be eligible to receive state vouchers.

For-profit schools would face additional financial reporting requirements. These institutions would, like public utilities, have to be transparent in how they establish their fee structures and would have a cap on their profit margin. That cap could be adjusted up or down slightly depending upon the degree to which the for-profit schools provide financial aid to their students. These restrictions undoubtedly would have an impact upon the attractiveness of for-profit higher education stocks in the eyes of investors. Moving for-profit stocks out of the hands of hedge-fund managers and into the hands of more conservative institutional investors would not be a bad outcome. And, of course, nothing would require a for-profit institution to seek HERA certification. Similarly, nothing would restrict a not-for profit school from transitioning into a for-profit institution.

Advantages of a choice program

The creation of a choice system for higher education simultaneously addresses the main inefficiencies that exist in the current structure. First, it enables the state to target its subsidies on the basis of its own priorities as well as to provide more equitable access to higher education. Under the current structure, more than 80 percent (\$5.6 billion) of the state's investment in 4-year higher education is provided without a means test.

Second, a choice system also would provide an incentive to **both** schools and students to complete degrees in a timely manner. Students who complete their degree faster will pay less out of pocket for their education. Schools that make courses available and support their students toward degree completion will be more sought after. Most importantly, any school not found to meet minimal academic and completion standards will no longer be eligible to enroll state-subsidized students.

Finally, a choice system would “get the prices right.” By opening up and leveling the playing field of the higher-education markets, the institutions formerly known as UCs and CSUs would now have to provide a certain quality of service and charge a price that reflects that quality and cost structure. If a school wants to provide small classes and a low pupil/instructor ratio, it may have to charge more for tuition. In the same manner, a school may pursue a cost structure that offers lower tuition in return for larger classes.

In a similar fashion, schools can decide just how much academic prestige is worth. Having a Nobel Prize-winning chemist on your faculty who demands a low teaching commitment and a high salary could be worth it if it means attracting a higher-quality student, possibly requiring a higher rate of tuition.

Students would face similar cost/benefit calculations. Just how much are they willing to pay for smaller classes or access to particular types of expertise? Similarly, they may be willing to pay more for a school with an established track record of graduating students on time. Once enrolled, decisions about dropping classes, changing majors, or even the willingness to enroll in a class at a less convenient time may be weighed against the cost of a subsidy’s running out or the potential to receive bonus funds for completing a program on time.

Shortcomings of choice

A choice program would not solve all of the problems of higher education in California. Such a change also would create some new challenges.

One of the most significant consequences of privatizing the UCs and CSUs would be the impact on access to resources for capital investments. As state institutions, the two systems enjoy access to borrowing authority and enter capital markets with investors knowing they are backed by the state. As independent non-profits, it may be more difficult for these schools to borrow money.

A second shortcoming associated with privatizing the provision of higher education in California would be more symbolic. These institutions serve as a source of pride for their communities, alumni, and residents across the state. Shifting ownership out of the hands of the state would have some impact on that sense of prestige. Though one would expect that the sense of allegiance would eventually be transferred to the successor schools, it would be a different relationship.

A SERIOUS DISCUSSION IS NEEDED ABOUT CALIFORNIA HIGHER EDUCATION

The current great recession has placed California’s higher education system under considerable stress. Despite these pressures, it is likely that higher education will continue, to play a critical role in supporting economic growth in the state. And as such, California will continue to see the value of subsidizing investment in this important public good. What the current economic crisis has brought to light, however, is just how modest a return the state gets on its rather substantial investment.

The voucher program proposed here addresses some of these issues. It breaks up the state’s monopoly over the provision of publicly subsidized higher education. It also places responsibility for the efficient use of the state’s subsidy in the hands of individual students. Those changes are likely to dramatically change the incentive structure for both the individual students as well as the institutions that provide higher education services. The result would be the completion of more degrees for the same amount of taxpayer investment. In short, more *bang* for the *buck*.

Critics of such a proposal will be many. Some will cite the need to maintain public institutions out of some sense of “civic pride.” That is an argument that sounds similar to those who contend that taxpayer dollars should be used to subsidize the building of professional sports facilities for major league teams. It is extremely difficult to compare trading off the inefficient use of taxpayer dollars in exchange for some sense of improved collective self-esteem. If, however, opponents of this voucher proposal want to engage in a debate that extends beyond symbolic notions of pride and identity, that would be a welcome discussion. Such a discussion, therefore, would have to engage the question of what is the state’s interest in subsidizing higher education and how can the state realize the most productive return on its investment. It is a discussion that is long overdue.