

Testimony

Testimony to the Texas House Higher Education Committee

Interim Charge: Factors That Have Contributed to the Rising Costs of Higher Education

by Andrew Gillen, Ph.D., and Erin Valdez

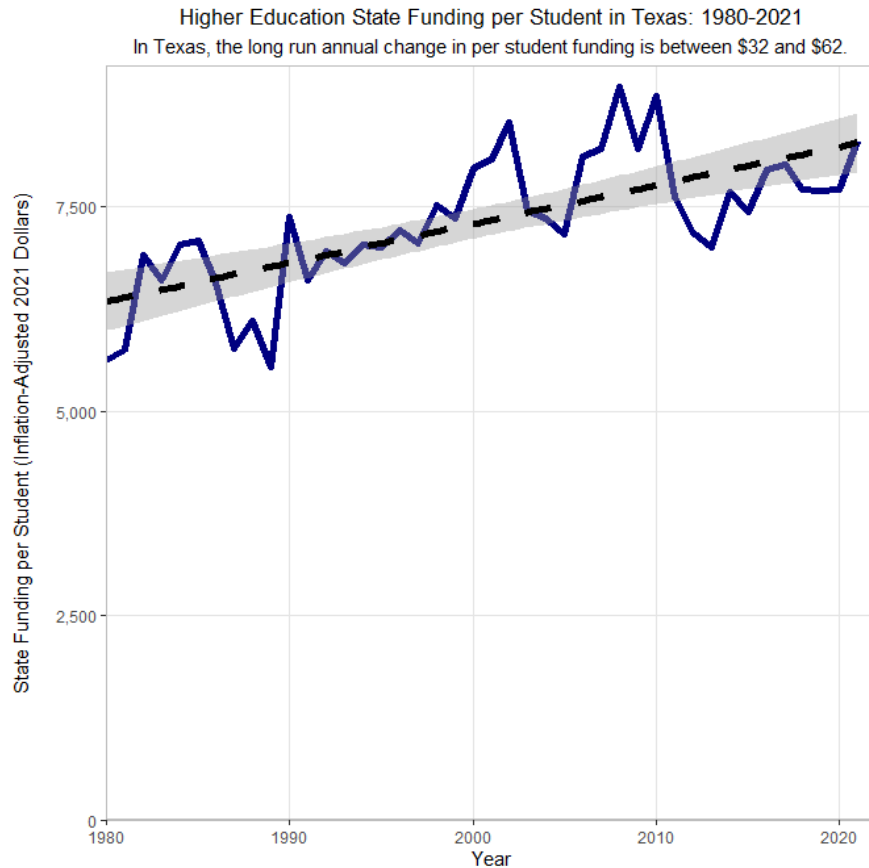
Chairman Murphy and Members of the Committee:

We are Andrew Gillen and Erin Valdez, policy analysts for Next Generation Texas at the Texas Public Policy Foundation. Thank you for the opportunity to provide the insights we have gained from years of studying these very issues.

There is no shortage of explanations for the rapid and sustained increase in college costs. Potential explanations that have received considerable attention include:

1. Increase in demand—if more students want to attend college and supply does not increase, this could drive up costs.
2. Decrease in supply—if the number of colleges or seats available at colleges decreases, this could drive up costs.
3. Composition effect—if student enrollment shifts to more expensive colleges, this could give the illusion of increasing prices even if prices are unchanged.
4. Third-party payments—people are less cost-conscious when someone else is paying.
5. Nonprofit management—cost control is not a primary goal for nonprofits.
6. Principal-agent problem—the interests of those running colleges (university administrations and faculty) do not necessarily align with the interests of those paying for it (the state and students).
7. State disinvestment—tuition may need to rise if state funding is cut.
8. Increases in institutional aid—if colleges give out more scholarship aid from their own resources, the real cost of college may not have increased that much.
9. Geographic integration—we moved from a regional to a national market for college, which increased the competitive pressure on colleges to spend more to move up the rankings.
10. Collusion—colleges have occasionally colluded to avoid competing on price.
11. Baumol's cost disease—increases in productivity elsewhere in the economy increase wages not just in those industries but also in labor-intensive industries like higher ed, driving up costs.
12. Bennett hypothesis—colleges respond strategically to increases in financial aid by raising tuition.
13. Bowen's revenue theory of costs—colleges have a mission orientation, meaning there is no limit to how much they will raise and spend.

Some of these explanations can largely be dismissed. For example, we have found that across the country, there has been no state disinvestment in higher education over the last four decades. In fact, state funding has increased over time ([Gillen, 2021](#)). The results are similar for Texas, as shown in the figure below, which documents that from 1980 to 2021, there has been a substantial increase in state funding per student.



Note. Data from *SHEF State Higher Education Finance FY 2021*, by State Higher Education Executive Officers Association, 2022 (https://shef.sheeo.org/wp-content/uploads/2022/06/SHEEO_SHEF_FY21_Report.pdf) and authors’ calculations. We adjusted the SHEF figures for inflation (the SHEF data are adjusted for costs, not inflation).

Similarly, Baumol’s cost disease, while sound in theory, is empirically minor. Between 1999 and 2015, faculty salary costs per student increased by \$600 but spending per student increased by \$6,000, meaning Baumol’s cost disease can account for only around 10% of the increase in spending ([Gillen, 2019](#)).

Of particular interest to this committee is Bowen’s revenue theory of costs, which accounts for as much as 66%–91% of the increase in spending per student, though this is an upper bound ([Gillen, 2015](#)). The implications for how to control costs are profound. Bowen argued that there are five laws of higher education costs:

1. “The dominant goals of institutions are educational excellence, prestige, and influence.
2. In quest of excellence, prestige, and influence, there is virtually no limit to the amount of money an institution could spend for seemingly fruitful educational needs.
3. Each institution raises all the money it can.
4. Each institution spends all it raises.
5. The cumulative effect of the preceding four laws is toward ever increasing expenditure.” (Bowen, 1980)

In other words, public and nonprofit colleges will always be able to spend more money in pursuit of their educational and research missions, so expecting cost control to emerge from within higher education is a lost cause. If costs are to be controlled, control must come from external sources, and importantly, the focus should be on the amount of total revenue, not on costs. For example, if this committee identified and forbade current spending it considers wasteful, even if faithfully implemented by colleges, this would have no impact on costs for students since that funding would simply be reallocated to a different activity.

From a college's perspective, revenue sources (state funding, tuition, philanthropy, etc.) are unrelated to each other. Colleges will seek to maximize revenue from each without regard to changes in the others. This means that we cannot buy lower tuition by increasing state funding. Colleges may agree to temporarily refrain from raising tuition, but over time, they will increase tuition as much as they can regardless of the level of state funding. Consider that from 1980 to 2021, inflation-adjusted state funding per student in Texas increased from \$5,600 to \$8,300. This substantial increase did not buy an equivalent decrease in tuition. In fact, tuition revenue per student increased from \$1,300 to \$5,100.

Rather than focusing on college spending (and fruitlessly engaging in a never-ending game of whack-a-mole), this committee should focus on revenue, as that is the ultimate determinant of spending. To control spending and costs, this committee first needs to determine how much total revenue per student colleges need. Texas can then use state funding to ensure both adequate resources and cost control. For example, consider two colleges that both increase tuition substantially. For a college with total revenue below the target amount, Texas could let such an increase take effect. But for a college with more revenue than necessary, that same increase should be met with an equivalent cut in state funding.

The bottom line is that if you want to control higher education costs and spending, you need to focus on revenue. ★

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Andrew Gillen, Ph.D., is a senior policy analyst at the Texas Public Policy Foundation and an adjunct professor of economics at Johns Hopkins University. Dr. Gillen's recent work has focused on how to reform federal financial aid, how state disinvestment is a myth, and how post-college earnings and debt should be used to inform student choice and government accountability.

Prior to joining the Foundation, Dr. Gillen spent over a decade at nonprofit and philanthropic organizations researching and trying to improve higher education. He was a program officer for the Charles Koch Foundation and served in research roles for American Institutes for Research, Education Sector; the American Council of Trustees and Alumni; and the Center for College Affordability and Productivity. He was also on the U.S. Department of Education's Advisory Committee on Student Financial Assistance.

Andrew has a PhD in economics from Florida State University and a BBA (business) degree from Ohio University.



Erin Davis Valdez is the policy director for Next Generation Texas, an initiative of the Foundation. She has been passionate about the transformational power of education all her life, having been given the gift of being homeschooled. She taught for over a decade in Austin-area schools and served as an assistant principal at a charter school in Lewisville. These experiences have given her the opportunity to see first-hand how students can thrive when they have excellent options.

Since joining the Foundation, Valdez has conducted research on career and technical education at the secondary and post-secondary levels, civics education, and welfare to work programs in Texas.

Valdez earned an M.A. in classics from the University of California, Santa Barbara and a B.A. in classical studies from Hillsdale College.

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